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No. 07-

IN THE

Supreme Court of the United States

CIRCUIT CITY STORES, INC.,

Petitioner,

v.

ROBERT GENTRY,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of California

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Federal Arbitration Act permits a court to refuse to enforce an agreement calling for individual arbitration based on state labor law policies that do not apply generally to "any contract." 9 U.S.C. § 2.

2. Whether the Federal Arbitration Act permits a state court to refuse to enforce an agreement to arbitrate based upon an unconscionability analysis "that takes its meaning precisely from the fact that a contract to arbitrate is at issue." *Perry* v. *Thomas*, 482 U.S. 483, 492 n.9 (1987).

LIST OF PARTIES AND AFFILIATES

The parties to the proceeding are set forth in the caption to this Petition.

Pursuant to Rule 29.6 of the Rules of this Court, petitioner Circuit City Stores, Inc. states that it has no parent corporation and that no publicly held company owns more than 10 percent petitioner's publicly traded stock.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Circuit City Stores, Inc. ("Circuit City") respectfully requests that this Court grant the petition for a writ of certiorari to review the decision and judgment of the California Supreme Court.

OPINIONS BELOW

The opinion of the California Supreme Court is reported at 165 P.3d 556 (Cal. 2007) and is reproduced in the Appendix to this Petition ("Pet. App.") at 1a to 55a. The California Supreme Court's denial of rehearing is unpublished and appears at Pet. App. 81a. The decision of the California Court of Appeal, Second Appellate District, Division Five, compelling arbitration appears at Pet. App. 56a-64a. The decision of the California Superior Court compelling arbitration appears at Pet. App. 75a-80a.

JURISDICTION

The California Supreme Court entered judgment on August 30, 2007, Pet. App. 1a, and denied a petition for rehearing on October 31, 2007, *id.* at 81a. This Court has jurisdiction over this petition for certiorari under 28 U.S.C. § 1257(a). Although the decision of the California Supreme Court envisions further proceedings in the lower courts, this Court has jurisdiction to review such judgments. See, *e.g.*, *Southland Corp.* v. *Keating*, 465 U.S. 1, 6-7 (1984); *Perry* v. *Thomas*, 482 U.S. 483, 489 n.7 (1987).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article VI, Clause 2 of the United States Constitution provides in pertinent part:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, provides in pertinent part:

> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist in law or equity for the revocation of any contract.

Section 1194 of the California Labor Code is reproduced in the Appendix at Pet. App. 82a.

STATEMENT OF THE CASE

This case presents issues of surpassing importance concerning the proper application of the Federal Arbitration Act ("FAA"). Respondent Robert Gentry was employed by Circuit City and later voluntarily agreed to resolve all employment disputes he might have with Circuit City through individual arbitration. He was given the opportunity to opt out of Circuit City's arbitration program, but declined to do so. Thereafter, Respondent ignored his agreement to arbitrate and instead filed a class action in state court claiming entitlement to overtime pay for himself and a class of other employees.

Both the California Superior Court and Court of Appeal applied generally applicable contract rules and held that Respondent must arbitrate his claims individually. In the decision below, the California

Supreme Court reversed and, in doing so, interposed two unlawful barriers to the enforcement of arbitration agreements that implicate broad conflicts with contrary federal circuit decisions and that cannot be reconciled with this Court's decisions.

First, the California Supreme Court refused to enforce the parties' agreement to arbitrate in accordance with its terms and remanded the case for an evaluation whether individual arbitration was consistent with California labor law. Pet. App. 23a, 41a. Conditioning enforcement of an arbitration agreement on compliance with state labor law runs contrary to Section 2 of the FAA, which provides that agreements to arbitrate are enforceable save upon grounds available for the "revocation of any contract." 9 U.S.C. § 2.

The California Supreme Court's contrary conclusion conflicts directly with the decisions of the Ninth Circuit and federal courts of appeals across the country. See *Bradley* v. *Harris Research, Inc.*, 275 F.3d 884, 889-90 (9th Cir. 2001); *Stawski Distrib. Co.* v. *Browary Zywiec S.A.*, 349 F.3d 1023, 1024-26 (7th Cir. 2003); *OPE Int'l LP* v. *Chet Morrison Contractors, Inc.*, 258 F.3d 443, 447 (5th Cir. 2001) (per curiam); *KKW Enters., Inc.* v. *Gloria Jean's Gourmet Coffees Franchising Corp.*, 184 F.3d 42, 50-51 (1st Cir. 1999); *Doctor's Assocs., Inc.* v. *Hamilton*, 150 F.3d 157, 163 (2d Cir. 1998); *cf. Management Recruiters Int'l* v. *Bloor*, 129 F.3d 851, 856 (6th Cir. 1997). These courts, applying Section 2 of the FAA and this Court's decisions in *Southland* and *Perry*, have held that agreements to arbitrate cannot be avoided based upon narrow state-law policies that do not apply generally to "any contract." The decision below thus interposes a barrier to arbitration that cannot be reconciled with these conflicting decisions.

Second, the California Supreme Court also violated the FAA when it reversed the Court of Appeal's and Superior Court's determination that the parties' agreement to arbitrate was not unconscionable. The California Supreme Court held that the arbitration agreement was "procedurally unconscionable" because even though Circuit City disclosed to Gentry the rules that would govern arbitration and explained "some of the shortcomings of arbitration," it "did not mention any of the additional significant disadvantages that *this particular arbitration agreement had compared to litigation.*" Pet. App. 37a (emphasis added).

That ruling conflicts with the FAA and this Court's decisions holding that a court may not refuse enforcement based upon state-law principles that are hostile to arbitration or depend on the fact that an arbitration agreement is at issue. See *Perry* v. *Thomas*, 482 U.S. 483, 492-93 n.9 (1987); *Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996). Further, the decision below conflicts with the Third Circuit's conclusion that state unconscionability standards are preempted by the FAA when they take their meaning from the fact that an agreement to arbitrate is at issue. See *Gay* v. *CreditInform*, __ F.3d ___, 2007 WL 4410362 (3d Cir. Dec. 19, 2007). Resolution of this conflict is even more important now that the Ninth Circuit has weighed in and declined "to follow the holding in *Gay*." *Lowden* v. *T-Mobile USA, Inc.*, ___ F.3d ___, 2008 WL 170279, at *8 n.3 (9th Cir. Jan. 22, 2008).

Review is warranted to resolve these mature and persistent conflicts between the decision of the California Supreme Court and the decisions of this Court and federal courts of appeals interpreting the requirements of the FAA. As explained by the

dissenting justices, the decision of the California Supreme Court undermines the benefits of arbitration by "alter[ing] the arbitral terms to which the parties agreed, and defeat[ing] the essential purposes and advantages of arbitration, by transforming that process, against the parties' expressed will at the time they entered the agreement, into something more and more like the court litigation arbitration is intended to avoid." Pet. App. 52a (Baxter, J., dissenting).

STATUTORY BACKGROUND

Section 2 of the FAA reflects "a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24-25 & n.32 (1983). Congress enacted the FAA in response "to hostility of American courts to enforcement of arbitration agreements." *Circuit City Stores, Inc.* v. *Adams*, 532 U.S. 105, 111 (2001). The "primary purpose" of the FAA is "ensuring that private agreements to arbitrate are enforced according to their terms." *Volt Info. Scis., Inc.* v. *Board of Trs.*, 489 U.S. 468, 479 (1989). Under the FAA, "questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration" and "any doubts concerning" a "defense to arbitrability" "should be resolved in favor of arbitration." *Moses H. Cone*, 460 U.S. at 24-25.

"[B]y agreeing to arbitrate, a party 'trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.'" *Gilmer* v. *Interstate/ Johnson Lane Corp.*, 500 U.S. 20, 31 (1991). Indeed, "it is typically a desire to keep the effort and expense

required to resolve a dispute within manageable bounds that prompts [parties] to forgo access to judicial remedies." *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633 (1985). As this Court has explained, enforcement of arbitration agreements provides "real benefits" in the "employment context," which "often involves" disputes over "smaller sums of money." *Adams*, 532 U.S. at 122-23; accord *Gilmer*, 500 U.S. at 24.

In Section 2 of the FAA, Congress limited the substantive grounds available for refusing to enforce an agreement to arbitrate to "grounds as exist at law or in equity for the revocation of any contract.'" *Perry* v. *Thomas*, 482 U.S. 483, 489 (1987) (quoting 9 U.S.C. § 2); accord *Southland Corp.* v. *Keating*, 465 U.S. 1, 10-11 (1984). Congress "intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements" based on state laws that do not provide a basis for the revocation of "*any* contract.'" *Id.* at 16 n.11 (quoting 9 U.S.C. § 2). The FAA's preemptive effect extends to state laws of "judicial origin" so that a "state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with . . . § 2." *Perry*, 482 U.S. at 492-93 n.9; *Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996) ("Courts may not . . . invalidate arbitration agreements under state laws applicable only to arbitration provisions").

FACTUAL BACKGROUND

a. In March 1995, Respondent Robert Gentry was employed by Circuit City as a Customer Service Manager. On March 29, 1995, Gentry attended a presentation about Circuit City's "Associate Issue Resolution Program ("AIRP"). That presentation

included a video and written materials describing the AIRP. Following the video presentation, Respondent signed a form confirming that he (i) had watched the video, (ii) had received copies of the explanatory materials, and (iii) had received a "Circuit City Arbitration Opt-Out Form." See Cal. S. Ct. Exhibits In Support of Petition for Writ of Mandate and/or Prohibition ("Cal. Exhs.") at 38. Gentry was advised that he should review these materials, consult with Circuit City or seek to consult with an attorney regarding Circuit City's arbitration proposal. *Id.* Respondent was given 30 days to decide whether to opt out of the arbitration agreement, and could do so simply by returning a one-page form. *Id.* Gentry chose not to do so. *Id.* at 35-36.

Respondent instead agreed to be bound by the Dispute Resolution Agreement ("Agreement"). The Agreement provides that "any and all employment-related legal disputes, controversies or claims arising out of, or relating to an Associate's . . . employment or cessation of employment with Circuit City . . . shall be settled exclusively by final and binding arbitration." *Id.* at 63, Agreement, Rule 2. As relevant here, the Agreement provides that "[t]he Arbitrator shall not consolidate claims of different Associates into one proceeding, nor shall the Arbitrator have the power to hear a class action." *Id.* at 68, Rule 9(f)(ii). Finally, the "Agreement and any award rendered pursuant to it shall be enforceable and subject to the Federal Arbitration Act, and the Uniform Arbitration Act of Virginia, regardless of the State in which the arbitration is held or the substantive law applied in the arbitration." *Id.* at 70, Rule 16 (citations omitted).

b. On August 29, 2002, Robert Gentry ignored his Agreement to arbitrate with Circuit City and instead

filed a class action in Superior Court of California. Gentry alleged that the "monetary damages sought" by plaintiff and "on behalf of each and every member of the class" exceeded the $25,000 "minimal jurisdiction limits of the Superior Court." Compl. ¶ 1; Cal. Civ. Proc. Code §§ 85, 88.

Gentry sought to represent "[a]ll California salaried customer service managers who worked overtime for [Circuit City] and were not paid overtime wages from within the four years preceding the filing of this complaint and up to the time defendants re-classified the position to non-exempt status." Compl. ¶ 11. Gentry advanced causes of action under Section 1194 of the California Labor Code, Section 17200 of the California Business and Professions Code, and common law conversion. *Id.* ¶¶ 10, 20, 24. In connection with these claims, Gentry sought recovery of (i) compensatory damages, (ii) "waiting time penalties" under California Labor Code § 203, (iii) "restitution and disgorgement of monies" under § 17200, (iv) "punitive and exemplary damages" for conversion, (v) "pre-judgment interest as allowed by California Labor Code Sections 1194 and 218.6," and (vi) "reasonable attorneys fees, expenses and costs provided by California Labor Code Sections 1194," and "other applicable California laws." Compl. at 14-15.

c. On February 28, 2003, the Superior Court granted Circuit City's motion to compel arbitration and ordered "plaintiff to arbitrate his claims on an individual basis." Pet. App. 75a. The court held that the agreement to arbitrate was not unconscionable because "Gentry was given the option of opting out of the arbitration agreement" but he "did not opt out." *Id.* at 79a.

The California Court of Appeal dismissed Gentry's appeal and subsequently denied his petition for writ of mandate. Pet. App. 72a. On November 19, 2003, the California Supreme Court granted Gentry's petition for review, and deferred further action pending its decision in *Discover Bank* v. *Superior Court*. *Id.* at 4a. On August 31, 2005, the California Supreme Court remanded this case to the Court of Appeal for reconsideration in light of its ruling in *Discover Bank*. *Id.* at 67a. On remand, the Court of Appeal again enforced the agreement to arbitrate because the "class action waiver" in the arbitration agreement "is neither procedurally nor substantively unconscionable." *Id.* at 59a.

The Court of Appeal explained that "the agreement at issue here does not have [an] adhesive element and therefore is not procedurally unconscionable" because "[s]igning the arbitration agreement was not made a condition of Gentry's employment" and "he was given 30 days to decide whether or not to opt out of the agreement, and chose not to do so." Pet. App. 61a. As such, Gentry was "free to decide whether or not the advantages of arbitration outweigh the disadvantages." *Id.* at 62a. The Court of Appeal distinguished *Discover Bank* because the Agreement was not a "'consumer contract of adhesion'" and did not "'predictably involve small amounts of damages.'" *Id.* at 63a. The court underscored that "Gentry has alleged statutory violations that could result in substantial damages and penalties should he prevail on his individual claims." *Id.* at 64a.

d. The California Supreme Court reversed. It concluded that enforcement of the parties' agreement to arbitrate individually turned on an evaluation of whether individual arbitration "would pose a serious obstacle to the enforcement of the state's overtime

laws." Pet. App. 1a. Specifically, the court ruled that "the statutory right to receive overtime pay embodied in section 1194 [of the California Labor Code] is unwaivable," *id.* at 12a, and that "under some circumstances [a provision requiring individual arbitration] would lead to a de facto waiver and would impermissibly interfere with employees' ability to vindicate unwaivable rights and to enforce the overtime laws," *id.* at 13a.[1]

The California Supreme Court held that enforcement of an agreement to arbitrate individually was contingent on an assessment whether a class action "is likely to be a significantly more effective practical means of vindicating the rights of the affected employees than individual litigation or arbitration" and whether "disallowance of the class action will likely lead to a less comprehensive enforcement of overtime laws for the employees alleged to be affected by the employer's violations." Pet. App. 23a. That inquiry would require a court to assess factors such as (i) "the potential for retaliation against members of the class," (ii) "the fact that absent members of the class may be ill informed of their rights," and (iii) a catch-all category encompassing "other real world obstacles to the vindication of class members' right to overtime pay through individual arbitration." *Id.* The court noted that this inquiry is "similar to the one [a court]

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[1] The court, however, ruled that "nothing in this opinion" prevents an employee from "entering into an individual *postdispute* arbitration agreement with Circuit City." Pet. App. 31a n.9 (emphasis added).

already makes to determine whether class actions are appropriate." *Id.* at 24a-25a.[2]

The court below rejected the argument that the FAA foreclosed its ruling. Pet. App. 26a-29a. The court acknowledged that the "United States Supreme Court has since held that the FAA does not permit states *to legislatively* prohibit arbitration of wage disputes," *id.* at 29a n.8 (emphasis added), but concluded that the FAA did not prohibit the court's refusal "to enforce, under some circumstances and in an arbitration-neutral manner . . . , provisions of arbitration agreements that significantly undermine the ability of employees to vindicate their statutory right to overtime pay." *Id.*

Separately, the California Supreme Court held that the agreement to arbitrate was procedurally unconscionable because although Circuit City "alluded to some of the shortcomings of arbitration in a general sense, it did not mention any of the additional significant disadvantages that *this particular arbitration agreement* had compared to litigation." Pet. App. 37a. Likewise, the court speculated that "it is not clear that someone in Gentry's position would have felt free to opt out." *Id.* at 39a.

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[2] The court dismissed the argument that "Gentry as an individual has not shown himself to be burdened by the class arbitration waiver" because it reasoned that "it makes little sense to focus only on whether the class representative himself or herself would be stymied in the pursuit of an individual arbitration remedy, rather than considering as well the difficulties for the class of employees affected by Circuit City's allegedly unlawful practices." Pet. App. 24a n.7 (citation omitted).

e. Justice Baxter, joined by Justices Chin and Corrigan, dissented. They explained that "there is no indication in the record that Gentry himself—the person whose contract for individual arbitration is actually before us—cannot, as a practical matter, vindicate his statutory overtime rights except through class proceedings." Pet. App. 46a. They highlighted that the practical impact of the majority's ruling was that notwithstanding an agreement to arbitrate individually, "the trial court may certify a class, in an overtime-wage case, *in any circumstance where it could otherwise do so.*" *Id.* at 47a.

The dissenters objected because the majority impermissibly "elevate[d] a mere judicial affinity for class actions as a beneficial device for implementing the wage laws above the policy expressed by . . . Congress . . . . that voluntary individual agreements to arbitrate—by which parties *give up* certain litigation rights and procedures *in return for* the relative speed, informality and cost efficiency of arbitration—should be enforced according to their terms." Pet. App. 48a-49a. The dissent explained that the majority had manifested its hostility to arbitration by "alter[ing] the arbitral terms to which the parties agreed, and defeat[ing] the essential purposes and advantages of arbitration, by transforming that process, against the parties' expressed will at the time they entered the agreement, into something more and more like the court litigation arbitration is intended to avoid." *Id.* at 52a.

Finally, the dissent would have affirmed the Court of Appeal's ruling that the Agreement was not procedurally unconscionable because "Circuit City provided Gentry, and other employees, with an extensive orientation about the program, then

allowed them a reasonable time to 'opt out.' without penalty simply by mailing back a form." Pet. App. 53a. They reasoned that because Gentry was afforded reasonable time to consult an attorney about the program, there was no basis for concluding that Circuit City misled its employees and there was no "evidence that it implied, threatened, or imposed any sanction for an employee's decision to opt out of the program." *Id.* at 55a.

REASONS FOR GRANTING THE PETITION

Review of the decision of the California Supreme Court is necessary to ensure the proper and uniform interpretation of the Federal Arbitration Act. This case presents an ideal vehicle to do so because the decision below squarely implicates conflicts among the federal courts on two recurring issues of national importance concerning the FAA. First, may courts refuse to enforce the terms of agreements to arbitrate based on narrow state policies that do not apply to "any contract" when the FAA mandates a "'liberal federal policy favoring arbitration agreements, notwithstanding state substantive or procedural policies to the contrary.'" *Perry* v. *Thomas*, 482 U.S. 483, 489 (1987) (quoting *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)). And, second, does the FAA allow arbitration-specific rules of unconscionability to provide a basis for refusing to enforce the terms of arbitration agreements. *Perry*, 482 U.S. at 492 n.9.

As to the first issue, under the decision below, enforcement of the terms of agreements to arbitrate can be denied not only on the narrow textual grounds set forth in Section 2 for the "revocation of any contract," 9 U.S.C. § 2, but also based upon countless policy preferences interposed by state legislatures

and courts in connection with virtually any substantive legal area from franchising law to consumer law to labor law. The decision below thus sets a dangerous precedent that threatens to undermine the benefits of arbitration under the FAA. Indeed, the FAA is predicated on the view that arbitration is valuable because it provides an alternative to litigation whereby parties can agree to resolve disputes through procedures that differ from those in litigation.

In adopting a broad view of the role that state policies should play in determining when the terms of arbitration agreements will be enforced, the California Supreme Court brought itself into conflict with decisions of five federal circuit courts – including the Ninth Circuit – which have held that agreements to arbitrate are fully enforceable save upon the textual grounds reflected in 9 U.S.C. § 2. Here, the California Supreme Court conditioned enforcement of the parties' agreement to arbitrate on an analysis whether individual arbitration was consistent with California labor law policies. That ruling is flatly inconsistent with the rule adopted by the federal circuits that have addressed this issue. See *supra* at 3. Indeed, the need for review is particularly stark because the decision below conflicts with the Ninth Circuit's decision in *Bradley* so that the requirements of the FAA in California depend on whether a case is pending in federal or state court.

As to the second issue, the California Supreme Court's separate "unconscionability" ruling likewise warrants review because it conflicts directly with the decisions of this Court explaining that enforcement of agreements to arbitrate cannot be predicated on a state-law principle that "takes its meaning precisely from the fact that an agreement to arbitrate is at

issue." *Perry*, 482 U.S. at 493 n.9; *Doctor's Assocs.*, 517 U.S. at 687. The court below ruled that the Agreement was unconscionable because Circuit City had failed to compare the relative "disadvantages" of "arbitration" to the advantages of litigation. That ruling impermissibly creates an arbitration-specific rule to assess the enforceability of arbitration agreements in direct contravention of this Court's decisions in *Perry* and *Doctor's Associates*. Moreover, the ruling below conflicts with the Third Circuit's recent decision explaining that the FAA imposes substantial limitations on the application of state unconscionability law to rewrite or strike down agreements to arbitrate.

I. THE DECISION BELOW IMPLICATES A DEEP CONFLICT ON WHETHER A COURT MAY REFUSE TO ENFORCE THE TERMS OF AN AGREEMENT TO ARBITRATE BASED ON STATE POLICIES THAT DO NOT APPLY TO "ANY CONTRACT."

Review should be granted because the decision of the California Supreme Court conflicts directly with a series of federal circuits on the question whether state-law policies other than those that apply to "any contract" may preclude enforcement of the terms of an agreement to arbitrate. 9 U.S.C. § 2.

a. On one side of the legal divide are federal circuit courts that follow the language of Section 2 of the FAA, which requires that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of *any contract*." 9 U.S.C. § 2 (emphasis added). These courts hold that state law that applies only to some, but not all, contracts, cannot defeat an agreement to arbitrate. See *Bradley* v. *Harris Research, Inc.*, 275 F.3d 884, 889-90 (9th Cir. 2001);

Stawski Distrib. Co. v. *Browary Zywiec S.A.*, 349 F.3d 1023, 1024-26 (7th Cir. 2003); *OPE Int'l LP* v. *Chet Morrison Contractors, Inc.*, 258 F.3d 443, 447 (5th Cir. 2001) (per curiam); *KKW Enters., Inc.* v. *Gloria Jean's Gourmet Coffees Franchising Corp.*, 184 F.3d 42, 50-51 (1st Cir. 1999); *Doctor's Assocs., Inc.* v. *Hamilton*, 150 F.3d 157, 163 (2d Cir. 1998); *cf. Management Recruiters Int'l* v. *Bloor*, 129 F.3d 851, 856 (6th Cir. 1997).

In *Bradley*, the Ninth Circuit held that Section 2 of the FAA preempted a state statute that would have blocked enforcement of an arbitration agreement because the statute applied only to franchise agreements. 275 F.3d at 890. *Bradley* reasoned that, under Section 2 of the FAA, "only state law that addresses the enforcement of 'contracts generally' is not preempted by the FAA." *Id.* at 889 (quoting *Doctor's Assocs.*, 517 U.S. at 687) (quotation marks omitted). Relying on decisions of the First, Second, Fifth, and Sixth Circuits, the Ninth Circuit held that the franchise statute "does not apply to 'any contract,'" and therefore was preempted by the FAA. *Id.* at 890 (quoting 9 U.S.C. § 2).

In *Bradley*, appellees contended–like the California Supreme Court in this case–that the state statute was not preempted "because it treats arbitration and litigation equally and does not single out arbitration as a disfavored form of dispute resolution." *Id.* at 889. The Ninth Circuit rejected that argument, holding that "only state law that addresses the enforcement of 'contracts generally' is not preempted by the FAA." *Id.* (quoting *Doctor's Assocs.*, 517 U.S. at 686-87). As *Bradley* explained, even if a state statute places arbitration on "equal footing" with litigation, it is preempted by the FAA if it is not generally applicable to all contracts. *Id.*; see *also*

Ting v. *AT&T*, 319 F.3d 1126, 1147-48 (9th Cir. 2003) (FAA preempts requirement in California's Consumer Legal Remedies Act (CLRA) that precluded waiver of class actions).

Likewise, the Fifth Circuit applied this same reasoning in *OPE International LP*, 258 F.3d 443. There, appellant argued that the arbitration agreement in question was invalid under a Louisiana statute applicable to construction contracts. The Fifth Circuit disagreed, holding that a state law that puts "a requirement" on arbitration clauses "not applicable to contracts generally" is preempted by Section 2 of the FAA. *Id.* at 447. The Fifth Circuit held that the state "'statute directly conflicts with § 2 of the FAA because the State's law conditions the enforceability of arbitration agreements on compliance with a . . . requirement not applicable to contracts generally.'" *Id.* (quoting *Doctor's Assocs.*, 517 U.S. at 687) (alteration omitted).

To the same effect is *KKW Enterprises, Inc.*, 184 F.3d 42. There, the First Circuit held that a state statute applicable only to franchise contracts was preempted by Section 2 of the FAA because it "does not apply to all contracts and does not establish a generally applicable contract defense." *Id.* at 52. The First Circuit reasoned that only state statutes that apply to "any contract" are consistent with the FAA. *Id.* at 50-51. That is, state statutes that apply only to one type of contract do not set forth "a generally applicable contract defense" and are therefore preempted by the FAA. *Id.* at 51.

Similarly, in *Doctor's Associates*, 150 F.3d 157, the Second Circuit held that Section 2 of the FAA preempted state law applicable only to franchise contracts because the law "did not establish a generally applicable contract defense that applies to

any contract." *Id.* at 163 (quotation marks omitted). Instead, the law simply "invalidated a franchise agreement's forum selection clause under the New Jersey Franchise Practices Act." *Id.* The Court noted that its holding meant that "state law" would play a more "narrow role . . . in FAA jurisprudence," *id.* at 162, but that precise result was mandated by the "FAA's strong policy in favor of rigorously enforcing arbitration agreements." *Id.*

Further, in *Stawski Distributing*, 349 F.3d 1023, the Seventh Circuit overturned the district court's order denying a "stay [of] litigation in favor of arbitration" and held that state law governing contracts between "brewers and distributors" was preempted because it did not apply generally to all contracts. *Id.* at 1024-25. The Seventh Circuit explained that the FAA "disables states from subjecting arbitration to rules that are not generally applicable to other contract choices," and therefore the result mandated by the FAA under these facts was that the state law was preempted and the arbitration must continue. *Id.* at 1025.

Taken together, these cases establish that five federal circuit courts have applied the unambiguous language of Section 2 of the FAA to hold that courts may not refuse to enforce agreements to arbitrate based on state-law grounds other than "grounds that exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2. Under the majority view, state law applicable to a limited set of contracts cannot, consistent with the FAA, provide a basis for refusing to enforce the terms of an agreement to arbitrate.

b. In conflict with the majority rule is the decision below as well as decisions by the Montana and Washington Supreme Courts. These courts have

invalidated arbitration agreements based on state law applicable only to a narrow subset of contracts and sought to support that result by noting that they apply the same or similar standards to non-arbitration agreements.

In the decision below, the California Supreme Court held that the enforceability of an agreement to arbitrate individually depends on a determination whether individual arbitration was consistent with state labor law policy. Pet. App. 23a. The Court further held that the state labor law is not preempted by the FAA, even though such policies are not applicable to contracts generally but only to labor contracts. *Id.* at 26a-29a. The California Supreme Court reasoned that its ruling was not preempted because it was "arbitration-neutral," *i.e.*, it treated contracts that called for litigation and arbitration the same. *Id.* at 27a.

In a similar vein, the Washington Supreme Court in *Scott* v. *Cingular Wireless*, 161 P.3d 1000 (Wash. 2007), invalidated an arbitration agreement based on a state law applicable to consumer contracts. *Id.* at 1008-09. Plaintiffs brought suit to invalidate an arbitration clause limiting class action arbitration, *id.* at 1002-03, and argued that the arbitration clause violated the state consumer protection act, which by its terms applies only to consumer contracts. *Id.* at 1005. The Washington Supreme Court invalidated the arbitration agreement because it concluded that individual arbitration was contrary to the state consumer protection law. *Id.* at 1008.[3]

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[3] *See Wisconsin Auto Title Loans, Inc.* v. *Jones*, 714 N.W.2d 155, 177-78 (Wis. 2006) (stating, in dicta, that FAA "preempts only those laws that target arbitration specifically while

In *Keystone, Inc. v. Triad Systems Corp.*, 971 P.2d 1240 (Mont. 1998), the Montana Supreme Court held that state law applying to contracts with arbitration clauses was not preempted by the FAA because it did not place arbitration agreements on "unequal footing." *Id.* at 1245 (internal quotation marks omitted). The *Keystone* Court examined the validity of an arbitration clause that required out-of-state arbitration against two Montana state statutes that required such disputes to be resolved within Montana. One statute applied to contracts that contained no arbitration clauses, while the other applied to contracts with arbitration clauses. *Id.* at 1244 ("'No agreement concerning venue . . . is valid unless the agreement requires that arbitration occur within the state of Montana.'") (quoting Mont. Code Ann. § 27-5-323). The Montana Supreme Court held that the arbitration-specific statute was not preempted by the FAA, *id.* at 1244-45, and rested its holding on the fact that even though the state arbitration law did not apply generally to "any contract," Montana law ultimately treated arbitration and litigation in the same manner. *Id.*[4]

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preserving through the savings clause state laws affecting contracts").

[4] Scholars likewise have acknowledged this conflict over the appropriate scope of the FAA. *Compare* Jean R. Sternlight, *The Rise and Spread of Mandatory Arbitration as a Substitute for the Jury Trial*, 38 U. San Fran. L. Rev. 17, 36-38 (2003) (arguing for narrow view of FAA preemption), *with* Christopher R. Drahozal, *Federal Arbitration Act Preemption*, 79 Ind. L.J. 393, 409 (2004) ("Lower courts are split on whether" statutes that govern only specific types of contracts "fall under the saving clause and avoid preemption."), *and* Stephen Hayford & Alan Palmiter, *Arbitration Federalism: A State Role in Commercial Arbitration*, 54 Fla. L. Rev. 175, 177 (2002) (discussing FAA preemption and noting that there "lies a murky sphere (a kind

c. Review is warranted in this case to resolve this fundamental conflict among the lower courts over the proper application of the FAA on issues that affect the rights of countless individuals and businesses across the country.

Under the majority rule, the FAA mandates the enforcement of agreements to arbitrate, in accordance with their terms, save upon grounds available for the revocation of "any contract." 9 U.S.C. § 2. In those cases, the lower courts hold that the FAA does not allow them to refuse to enforce agreements to arbitrate based upon narrow state policies such as: (i) franchise law (*Bradley*, 275 F.3d at 889-90 (9th Cir.); *Doctor's Assocs.*, 150 F.3d at 163 (2d Cir.); *KKW Enters.*, 184 F.3d at 51-52 (1st Cir.)); (ii) construction law (*OPE Int'l*, 258 F.3d at 447 (5th Cir.)); (iii) consumer law (*Ting*, 319 F.3d at 1147-48 (9th Cir.)); and (iv) brewer and distributor law (*Stawski*, 349 F.3d at 1024 (7th Cir.)).

These decisions closely follow this Court's decisions holding that California franchise and labor law do not provide a basis for refusing to enforce an agreement to arbitrate. See *Southland Corp.* v. *Keating*, 465 U.S. 1, 16 n.11 (1984) ("[T]he defense to arbitration found in the California Franchise Investment Law is not a ground that exists in law or at equity 'for the revocation of *any* contract'"); *Perry*, 482 U.S. at 490-91 (1987) (FAA preempts California state policy that required litigation of labor disputes). Indeed, in *Perry*, this Court struck down a California statute that precluded arbitration in cases involving labor disputes. This Court explained that, under the

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of boundary) where the FAA speaks, but without the same clarity and force as in the legislation's provisions on enforceability and arbitrability").

Supremacy Clause, California's requirement that "litigants be provided a judicial forum for resolving wage disputes" "must give way" to the FAA's requirement that arbitration agreements "be 'rigorously enforce[d].'" *Id.* at 490, 491 (quoting *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213, 221 (1985)). This Court explained that the FAA constrained state law "whether of legislative or *judicial origin*," because otherwise a court could "effect what we hold today the state legislature cannot." *Id.* at 492 n.9 (emphasis added).

In stark contrast, the decision below holds that enforcement of the terms of an agreement to arbitrate can be denied based on state law policies applicable not to "any contract" but based on California labor law. Pet. App. 1a, 23a. Here, the California Supreme Court made enforcement of the terms of the parties' agreement to arbitrate contingent on an assessment whether the individual arbitration agreed to by the parties is consistent with labor law. Enforcement is thus made to depend on matters such as (i) "the potential for retaliation," (ii) the possibility that "members of the class may be ill informed about their rights," and (iii) "other real world obstacles to the vindication of class members' right to overtime pay through individual arbitration." *Id.* at 23a.

Such a broad and sweeping limitation of the federal policy mandating enforcement of arbitration agreements is a far cry from the specific textual grounds set forth in Section 2 of the FAA and fundamentally inconsistent with "Congress's clear intent . . . to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible." *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 22 (1983). Further, the open-ended analysis of potential impact on third parties is flatly

contrary to this Court's precedent that the FAA requires (i) "an expeditious and summary hearing, with only restricted inquiry into factual issues," *id.*, and (ii) that, under the FAA, "an arbitration agreement must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement," *id.* at 20; see *Dean Witter*, 470 U.S. at 221 (FAA "*requires* piecemeal resolution when necessary to give effect to an arbitration agreement").

Further, the California Supreme Court squarely rejected the argument that the federal "policy in favor of enforcing arbitration agreements as written overrides the statutory policy in favor of vigorously enforcing overtime laws." Pet App. 28a n.8. That judge-made preference for state-law labor law over binding federal law violates the Supremacy Clause of the United States Constitution. Indeed, the California Supreme Court's preference for narrow state law policies as a basis for undoing private agreements to arbitrate is indistinguishable from the impermissible policies adopted by the California legislature that this Court held were preempted by the FAA. See *Southland*, 465 U.S. at 10-11; *Perry*, 482 U.S. at 491.[5] In effect, the California Supreme Court has, through judicial decision, refused to enforce the terms of an agreement to arbitrate based on the same narrow state law grounds that this Court rejected when attempted by the California legislature. *Id.* at 492-93 & n.9.

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[5] The court below sought to distinguish *Perry*, arguing that it stands solely for the proposition that "the FAA does not permit states to legislatively prohibit arbitration of wage disputes." Pet. App. 29a n.8. The *Perry* Court, however, made clear that the FAA preempted state law "whether of legislative or judicial origin." 482 U.S. at 492 n.9.

The California Supreme Court's conclusion that its ruling is not preempted by the FAA because it was refusing to enforce the parties' agreement in an "arbitration-neutral manner," Pet. App. 29a n.8, is precisely the argument that the federal circuit courts applying the majority rule have rejected. Thus, the Ninth Circuit in *Bradley* held that the FAA preempted California law that "affect[ed] both arbitration and litigation" because it did not apply to "contracts generally." 275 F.3d at 889. A contrary rule would allow courts to show hostility to arbitration by altering the "arbitral terms to which the parties agreed . . . into something more and more like the court litigation arbitration is intended to avoid." Pet. App. 52a (Baxter, J., dissenting).

Lastly, the enforceability of arbitration clauses governed by the FAA should not depend on geography under any circumstances. But the decisional conflict is particularly acute here where the outcome will vary depending on whether the litigation arises in federal court on one side of the street (and therefore will be governed by the Ninth Circuit's rule in *Bradley*) or is brought on the other side (and is thus subject to California's rule in *Gentry*). This is an intolerable situation and the Court should grant certiorari to eliminate the race to the courthouse that no doubt will be engendered.

II. THE UNCONSCIONABILITY RULING IN THE DECISION BELOW CONFLICTS WITH DECISIONS OF THIS COURT AND THE THIRD CIRCUIT.

Review also should be granted because the California Supreme Court's "unconscionability" ruling conflicts both with this Court's decisions and implicates a conflict among the federal circuits.

a. In *Perry*, this Court ruled that a court may not avoid the preemptive effect of the FAA through "[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue." *Perry*, 482 U.S. at 493 n.9. Thus, "in assessing the rights of litigants to enforce an arbitration agreement," a court may not "construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law" or "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." *Id.*

Following *Perry*, this Court in *Doctor's Associates* examined a state-law rule that made agreements to arbitrate unenforceable unless "'notice that [the] contract is subject to arbitration [is] typed in underlined capital letters on the first page of the contract.'" 517 U.S. at 684. This Court held that the Montana law was preempted by the FAA because the State's "first-page notice requirement" applied "specifically and solely" to "contracts 'subject to arbitration'" and not to "'any contract.'" *Id.* This Court reasoned that Montana law was displaced because it "conditions the enforceability of arbitration agreements on compliance with a special notice requirement not applicable to contracts generally." *Id.* at 687.

b. The California Supreme Court's unconscionability ruling conflicts with *Perry* and *Doctor's Associates* because it impermissibly imposes requirements governing the enforceability of the terms of agreements to arbitrate that are not applicable to non-arbitration agreements.

First, the court below concluded that the agreement to arbitrate was procedurally unconscionable—

despite a 30-day period during which Gentry could have opted out without any adverse consequence—because Circuit City "did not mention any of the additional significant disadvantages that *this particular arbitration agreement* had compared to litigation." Pet. App. 37a.

An arbitration-specific requirement that an individual be specifically provided an explanation of the "disadvantages" of arbitration as compared to litigation is precisely what this Court has confirmed the FAA precludes: "Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." *Perry*, 482 U.S. at 492 n.9. To be clear, there is no question that Circuit City disclosed the rules governing arbitration. Indeed, the court below acknowledged that "an employee who read Circuit City's nine-page single-spaced document entitled Circuit City's 'Dispute Resolution Rules and Procedures' would have encountered" the provisions governing the parties' arbitration. Pet. App. 38a. What the court below required—and what the FAA prohibits—is an additional arbitration-specific obligation to disclose every possible way in which the rules of arbitration might be deemed "less favorable to an employee than those operating in a judicial forum." *Id.*

The standard applied by the California Supreme Court likewise conflicts with *Doctor's Associates* because the court below interposed an obligation—*i.e.*, to catalog all of the potential disadvantages of arbitration when compared to litigation – that applies solely to agreements to arbitrate and not to nonarbitration agreements. 517 U.S. at 687 ("Courts may not . . . invalidate arbitration agreements under state laws applicable *only* to arbitration provisions.").

Indeed, the court below nowhere suggested any parallel obligation for nonarbitration agreements to identify the *disadvantages* of litigation as compared to arbitration. As such, the California Supreme Court improperly "'requir[ed] greater information . . . in the making of agreements to arbitrate than in other contracts.'" *Id.* (citation omitted).

The California Supreme Court's ruling is particularly pernicious because *every* arbitration agreement can be deemed procedurally unconscionable based upon the grounds advanced by the decision below. As noted, at its core, arbitration is beneficial because it provides individuals with an alternative to litigation: "[B]y agreeing to arbitrate, a party 'trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.'" *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991). Under the ruling below, an arbitration agreement would be deemed procedurally unconscionable based solely on a failure to anticipate, in an explanatory handbook, each and every possible disadvantage of arbitration as compared to litigation. Such a ruling would cripple the ability of parties to choose arbitration as an alternative to litigation, a choice that "may be of particular importance in employment litigation, which often involves smaller sums of money than disputes concerning commercial contracts." *Circuit City Stores, Inc.* v. *Adams*, 532 U.S. 105, 123 (2001).

The California Supreme Court also speculated that "it is not clear that someone in Gentry's position would have felt free to opt out" because "Circuit City preferred that the employee participate in the arbitration program." Pet. App. 39a. Under California law, however, the party opposing enforce-

ment of a contract has the affirmative burden of proving unconscionability. *E.g.*, *Brutoco Eng'g & Constr., Inc.* v. *Superior Court*, 107 Cal. App. 4th 1326, 1331 (2003). Here, "Gentry signed an easily readable, one-page form that accompanied receipt of the Associate Issue Resolution Package," which explained the procedures if he wanted to *opt out* of arbitration with Circuit City. Pet. App. 32a-33a. The majority cited no support for its novel view that where an employer has a preference for *arbitration*, its employees (even if offered an opt out) will be deemed to have been coerced into agreeing to arbitrate. To the contrary, the law is settled that "[m]ere inequality in bargaining power . . . is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context." *Gilmer*, 500 U.S. at 33.[6]

c. The California Supreme Court's unconscionability ruling also conflicts with the Third Circuit's decision in *Gay* v. *CreditInform*, ___ F.3d ___ 2007

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[6] *See* Michael G. McGuinness & Adam J. Karr, *California's "Unique" Approach to Arbitration: Why This Road Less Traveled Will Make All the Difference on the Issue of Preemption Under the Federal Arbitration Act*, 2005 J. Disp. Resol. 61, 62 (2005) ("California has created a new brand of unconscionability. It is far more demanding—and it is unique to arbitration."); Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 Buff. L. Rev. 185, 186 (2004) ("[J]udges find unconscionable specific features of arbitration agreements, such as forum selection clauses and confidentiality requirements, which are routinely enforced as unobjectionable in nonarbitration agreements"); Stephen J. Ware, *Arbitration and Unconscionability After* Doctor's Associates, Inc. v. Casarotto, 31 Wake Forest L. Rev. 1001, 1034 (1996) ("Judicial decisions apply unconscionability, and other common law doctrines, more aggressively to arbitration agreements than to other contracts.").

WL 4410362 (3d Cir. Dec. 19, 2007).[7] In *Gay*, the Third Circuit applied this Court's decision in *Perry* and explained that the FAA "distinguished state law principles that apply to contracts generally from those that are unique to arbitration agreements." *Id.* at *20. The *Gay* Court ruled that an agreement to arbitrate a consumer dispute as a class action was enforceable even if such an agreement would be deemed "unconscionable" as a matter of Pennsylvania decisional law.

The Third Circuit rejected the argument that Pennsylvania unconscionability law was insulated from further scrutiny under the FAA. *Id.* The Third Circuit instead concluded that the "unconscionability" rulings under Pennsylvania law would be preempted by the FAA because those rulings "deal with agreements to arbitrate, rather than with contracts in general." *Id.* Specifically, the *Gay* Court explained that state-law "unconscionability" rules were preempted when they "rel[y] on the uniqueness" of the arbitration provision. *Id.*

The Third Circuit's decision is in direct conflict with the decision below, because the California Supreme Court's unconscionability analysis centered on the fact that an agreement to arbitrate was at issue. The court below adopted an unconscionability standard based upon arbitration-specific rules that, by their terms, do not apply to nonarbitration contracts. In

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[7] *Accord Iberia Credit Bureau, Inc.* v. *Cingular Wireless LLC*, 379 F.3d 159, 167 (5th Cir. 2004) ("Even when using doctrines of general applicability, state courts are not permitted to employ those general doctrines in ways that subject arbitration clauses to special scrutiny."); *Banc One Acceptance Corp.* v. *Hill*, 367 F.3d 426, 432 (5th Cir. 2004) (same).

stark contrast, the Third Circuit has explained that such rules are preempted by the FAA.

The need to resolve this conflict is even more pressing now that the Ninth Circuit has considered the issue and declined "to follow the holding in *Gay*." *Lowden* v. *T-Mobile USA, Inc.*, ___ F.3d ___, 2008 WL 170279, at *8 n.3 (9th Cir. Jan. 22, 2008).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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January 29, 2008

APPENDIX A

SUPREME COURT OF CALIFORNIA

No. S141502

ROBERT GENTRY,
Petitioner,

v.

THE SUPERIOR COURT OF LOS ANGELES COUNTY,
Respondent,

CIRCUIT CITY STORES, INC.,
Real Party in Interest.

Aug. 30, 2007
Rehearing Denied Oct. 31, 2007

MORENO, J.

In this case we consider whether class arbitration waivers in employment arbitration agreements may be enforced to preclude class arbitrations by employees whose statutory rights to overtime pay pursuant to Labor Code sections 500 et seq. and 1194[1] allegedly have been violated. We conclude that at least in some cases, the prohibition of classwide relief would undermine the vindication of the employees' unwaivable statutory rights and would pose a serious obstacle to the enforcement of the state's overtime laws. Accordingly, such class arbitration waivers should not be enforced if a trial court determines, based on the factors discussed below, that class

[1] All statutory references are to this code unless otherwise indicated.

arbitration would be a significantly more effective way of vindicating the rights of affected employees than individual arbitration. We therefore reverse the judgment of the Court of Appeal upholding the class arbitration waiver and remand for the above determination.

Another issue posed by this case is whether a provision in an arbitration agreement that an employee can opt out of the agreement within 30 days means that the agreement is not procedurally unconscionable, thereby insulating it from employee claims that the arbitration agreement is substantively unconscionable or unlawfully exculpatory. As explained below, a finding of procedural unconscionability is not required to invalidate a class arbitration waiver if that waiver implicates unwaivable statutory rights. But such a finding is a prerequisite to determining that the arbitration agreement as a whole is unconscionable. Plaintiff in this case argues that other terms of the arbitration agreement were substantively unconscionable and that the entire agreement should not be enforced. Contrary to the Court of Appeal, we conclude the present agreement has an element of procedural unconscionability notwithstanding the opt-out provision, and therefore remand for a determination of whether provisions of the arbitration agreement were substantively unconscionable.

I. STATEMENT OF FACTS

The facts are for the most part not in dispute. On August 29, 2002, Robert Gentry filed a class action lawsuit in superior court against Circuit City Stores, Inc. (Circuit City), seeking damages for violations of the Labor Code and Business and Professions Code,

as well as for conversion. Gentry filed suit on behalf of salaried customer service managers such as himself whom Circuit City had allegedly "illegally misclassified" as "exempt managerial/executive employees" not entitled to overtime pay, when in fact, they were "'non-exempt' non-managerial employees" entitled to be compensated for hours worked in excess of eight hours per day and 40 hours per week.

When he was hired by Circuit City in 1995, Gentry received a packet that included an "Associate Issue Resolution Package" and a copy of Circuit City's "Dispute Resolution Rules and Procedures," pursuant to which employees are afforded various options, including arbitration, for resolving employment-related disputes. By electing arbitration, the employee agrees to "dismiss any civil action brought by him in contravention of the terms of the parties' agreement." The agreement to arbitrate also contains a class arbitration waiver, which provides: "The Arbitrator shall not consolidate claims of different Associates into one proceeding, nor shall the Arbitrator have the power to hear arbitration as a class action. . . ." As will be explained at greater length below, the arbitration agreement also contained several limitations on damages, recovery of attorney fees, and the statute of limitations that were less favorable to employees than were provided in the applicable statutes. The packet included a form that gave the employee 30 days to opt out of the arbitration agreement. Gentry did not do so.

At that time, there was a split of authority in California on the enforceability of class action waivers in consumer contracts. (See *Szetela v. Discover Bank* (2002) 97 Cal.App.4th 1094, 118 Cal.Rptr.2d

862 [waivers unconscionable]; *Discover Bank v. Superior Court* (2003) 105 Cal.App.4th 326, 129 Cal.Rptr. 2d 393 [waivers must be upheld under the Federal Arbitration Act], overruled by *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148, 30 Cal.Rptr.3d 76, 113 P.3d 1100 (*Discover Bank*).) Circuit City moved to compel arbitration. The court acknowledged that the governing case law was "conflicting and in a state of flux," and elected to follow the Court of Appeal decision in *Discover Bank v. Superior Court.* The court did hold two provisions of the agreement (cost splitting and limitation of remedies provisions) substantively unconscionable based on federal case law. (*Morrison v. Circuit City Stores, Inc.* (6th Cir.2003) 317 F.3d 646.) The court severed those provisions from the agreement, ordered Gentry to "arbitrate his claims on an individual basis and submit to the class action waiver," and stayed the superior court action.

Gentry filed a mandate petition on September 9, 2003. The Court of Appeal denied the petition, noting that the issue of the enforceability of the class action waiver was before this court in *Discover Bank.* We granted Gentry's petition for review and deferred briefing pending our decision in *Discover Bank.* On June 27, 2005, we issued our decision in *Discover Bank, supra,* 36 Cal.4th 148, 30 Cal.Rptr.3d 76, 113 P.3d 1100. As discussed at greater length below, we held that "at least under some circumstances, the law in California is that class action waivers in consumer contracts of adhesion are unenforceable" as unconscionable. (*Discover Bank, supra,* 36 Cal.4th at p. 153, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) We remanded this case for reconsideration in light of *Discover Bank.*

On remand, the Court of Appeal again denied Gentry's petition for writ of mandate. It distinguished the class arbitration waiver in this case from the one found unconscionable in *Discover Bank* on two principal grounds. First, the court held that the agreement was not unconscionable because of the 30-day opt-out provision. Because of this provision, "the agreement at issue here does not have that adhesive element and therefore is not procedurally unconscionable."

Second, for reasons elaborated on below, it found the class arbitration waiver here was distinguishable from the one in *Discover Bank* and not substantively unconscionable because the present case, unlike *Discover Bank*, did not involve "predictably . . . small amounts of damages." (*Discover Bank, supra*, 36 Cal.4th at p. 162, 30 Cal.Rptr.3d 76, 113 P.3d 1100.)

We granted review to clarify our holding in *Discover Bank*.

II. Discussion

A. Class Arbitration Waiver in Overtime Cases May Be Contrary to Public Policy

In *Discover Bank*, the plaintiff sought to prosecute a class action against a credit card company that had allegedly defrauded a large number of customers for small amounts of money, as low as $29 in the plaintiff's case. (*Discover Bank, supra,* 36 Cal.4th at p. 154, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) The credit card company had inserted into its agreement with its customers an amendment by sending a notice to its customers and informing them that continued use of the account would constitute acceptance of the terms of the amendment. The amendment required arbitration of all disputes and prohibited classwide

arbitration. (*Id.*, at pp. 153-154, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) In finding such agreements generally unconscionable under California law, we started out reviewing the policies in favor of class actions and class arbitration[2] in consumer actions, quoting *Vasquez v. Superior Court* (1971) 4 Cal.3d 800, 808, 94 Cal.Rptr. 796, 484 P.2d 964 (*Vasquez*): "'Frequently numerous consumers are exposed to the same dubious practice by the same seller so that proof of the prevalence of the practice as to one consumer would provide proof for all. Individual actions by each of the defrauded consumers is often impracticable because the amount of individual recovery would be insufficient to justify bringing a separate action; thus an unscrupulous seller retains the benefits of its wrongful conduct. A class action by consumers produces several salutary by-products, including a therapeutic effect upon those sellers who indulge in fraudulent practices, aid to legitimate business enterprises by curtailing illegitimate competition, and avoidance to the judicial process of the burden of multiple litigation involving identical claims. The benefit to the parties and the courts would, in many circumstances, be substantial.'" (*Discover Bank, supra*, 36 Cal.4th at p. 156, 30 Cal. Rptr.3d 76, 113 P.3d 1100.)

Because of the importance of class actions in consumer litigation, we concluded that "at least some class action waivers in consumer contracts are unconscionable under California law. First, when, a consumer is given an amendment to its cardholder agreement in the form of a 'bill stuffer' that he would

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[2] For the sake of economy, this opinion will sometimes refer to class action litigation and class arbitrations generically as "class actions."

be deemed to accept if he did not close his account, an element of procedural unconscionability is present. [Citation.] Moreover, although adhesive contracts are generally enforced [citation], class action waivers found in such contracts may also be substantively unconscionable inasmuch as they may operate effectively as exculpatory contract clauses that are contrary to public policy. As stated in Civil Code section 1668: 'All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law.'. . .

"Class action and arbitration waivers are not, in the abstract, exculpatory clauses. But because, as discussed above, damages in consumer cases are often small and because '"[a] company which wrongfully exacts a dollar from each of millions of customers will reap a handsome profit"' [citation], '"the class action is often the only effective way to halt and redress such exploitation."' [Citation.] Moreover, such class action or arbitration waivers are indisputably one-sided. 'Although styled as a mutual prohibition on representative or class actions, it is difficult to envision the circumstances under which the provision might negatively impact Discover [Bank], because credit card companies typically do not sue their customers in class action lawsuits.' [Citation.] Such one-sided, exculpatory contracts in a contract of adhesion, at least to the extent they operate to insulate a party from liability that otherwise would be imposed under California law, are generally unconscionable." (*Discover Bank, supra*, 36 Cal.4th at pp. 160-161, 30 Cal.Rptr.3d 76, 113 P.3d 1100, italics omitted.)

We clarified that "[w]e do not hold that all class action waivers are necessarily unconscionable. But when the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then, at least to the extent the obligation at issue is governed by California law, the waiver becomes in practice the exemption of the party 'from responsibility for [its] own fraud, or willful injury to the person or property of another.' (Civ.Code, § 1668.) Under these circumstances, such waivers are unconscionable under California law and should not be enforced." (*Discover Bank, supra,* 36 Cal.4th at pp. 162-163, 30 Cal.Rptr.3d 76, 113 P.3d 1100.)

We also concluded in *Discover Bank* that it was unnecessary to abandon the arbitration forum in order to address the claims of a class of consumers. Rather, class arbitration was a well-accepted alternative to class litigation on the one hand and individual arbitration on the other. (*Discover Bank, supra,* 36 Cal.4th at pp. 157-158, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) We noted that class arbitration has been in use for the last 20 years and that rules concerning such arbitration have been incorporated into various dispute resolution services. (*Id.*, at p. 172, 30 Cal. Rptr.3d 76, 113 P.3d 1100.)

In *Discover Bank*, before discussing the general principles of unconscionability on which that decision was based, we noted that the Court of Appeal in *America Online, Inc. v. Superior Court* (2001) 90 Cal. App.4th 1, 108 Cal.Rptr.2d 699 (*AOL*), had invali-

dated a Virginia choice-of-law provision in a consumer contract with no arbitration agreement that effectively would have disallowed the pursuit of a class action. The plaintiff sought class relief pursuant to California's Consumer Legal Remedies Act (CLRA) (Civ.Code, § 1750 et seq.), which specifically authorizes such class actions (Civ.Code, § 1781), and which further provides in Civil Code section 1751 that "'[a]ny waiver by a consumer of the provisions of this title is contrary to public policy and shall be unenforceable and void.'" (*Discover Bank, supra*, 36 Cal.4th at p. 158, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) We noted that the plaintiff in *Discover Bank* did "not plead a CLRA cause of action and so does not invoke its antiwaiver provision; nor does he seek recovery under any other California statute as to which a class action remedy is essential" (*id.*, at p. 160, 30 Cal. Rptr.3d 76, 113 P.3d 1100, fn. omitted) apparently because the plaintiff sought to pursue a national class action suit and had made a strategic decision not to rely on a California statute. (*Discover Bank, supra*, 36 Cal.4th at p. 160, fn. 2, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) Accordingly, we had no occasion in *Discover Bank* to consider whether a class action or class arbitration waiver would undermine the plaintiff's statutory rights.

In the present case, Gentry's lawsuit is pursuant to statute. Section 510 provides that nonexempt employees will be paid one and one-half their wages for hours worked in excess of eight per day and 40 per week and twice their wages for work in excess of 12 hours a day or eight hours on the seventh day of work. Section 1194 provides a private right of action to enforce violations of minimum wage and overtime

laws.[3] That statute states: "*Notwithstanding any agreement* to work for a lesser wage, any employee receiving less than the legal minimum wage or the legal overtime compensation applicable to the employee is entitled to recover in a civil action the unpaid balance of the full amount of this minimum wage or overtime compensation, including interest thereon, reasonable attorney's fees, and costs of suit." (§ 1194, subd. (a), italics added.) By its terms, the rights to the legal minimum wage and legal overtime compensation conferred by the statute are unwaivable. "Labor Code section 1194 confirms 'a clear public policy . . . that is specifically directed at the enforcement of California's minimum wage and overtime laws for the benefit of workers.'" (*Sav-On Drug Stores, Inc. v. Superior Court* (2004) 34 Cal.4th 319, 340, 17 Cal.Rptr.3d 906, 96 P.3d 194 (*Sav-On Drug Stores*).) Although overtime and minimum wage laws may at times be enforced by the Department of Labor Standards Enforcement (DLSE), it is the clear intent of the Legislature in section 1194 that minimum wage and overtime laws should be enforced in part by private action brought by aggrieved employees. (See *Bell v. Farmers Ins. Exchange* (2004) 115 Cal.App.4th 715, 746, 9 Cal. Rptr.3d 544 (*Bell*) [noting declaration of former chief counsel of DLSE indicating that without private enforcement through class actions department's resources to resolve claims would be overtaxed].)

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[3] Although Gentry pleads causes of action under Business and Professions Code section 17200 et seq. as well as for common law conversion, these actions are based on Circuit City's alleged violation of the overtime laws, which section 1194 is intended to enforce. We therefore focus on the ability of employees to vindicate their rights pursuant to section 1194.

The public importance of overtime legislation has been summarized as follows: "An employee's right to wages and overtime compensation clearly have different sources. Straight-time wages (above the minimum wage) are a matter of private contract between the employer and employee. Entitlement to overtime compensation, on the other hand, is mandated by statute and is based on an important public policy. . . . 'The duty to pay overtime wages is a duty imposed by the state; it is not a matter left to the private discretion of the employer. [Citations.] California courts have long recognized [that] wage and hours laws "concern not only the health and welfare of the workers themselves, but also the public health and general welfare." [Citation.] . . . [O]ne purpose of requiring payment of overtime wages is "'to spread employment throughout the work force by putting financial pressure on the employer. . . .'" [Citation.] Thus, overtime wages are another example of a public policy fostering society's interest in a stable job market. [Citation.] Furthermore . . . the Legislature's decision to criminalize certain employer conduct reflects a determination [that] the conduct affects a broad public interest. . . . Under Labor Code section 1199 it is a crime for an employer to fail to pay overtime wages as fixed by the Industrial Welfare Commission.'" (*Earley v. Superior Court* (2000) 79 Cal.App.4th 1420, 1430, 95 Cal.Rptr.2d 57.) Moreover, the overtime laws also serve the important public policy goal of protecting employees in a relatively weak bargaining position against "'the evil of "overwork."'" (*Barrentine v. Arkansas-Best Freight System* (1981) 450 U.S. 728, 739, 101 S.Ct. 1437, 67 L.Ed.2d 641 [commenting on overtime provision of the federal Fair Labor Standards Act].)

In short, the statutory right to receive overtime pay embodied in section 1194 is unwaivable. In *Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, 99 Cal.Rptr.2d 745, 6 P.3d 669 (*Armendariz*), we held that when an employee is bound by a predispute arbitration agreement to adjudicate unwaivable statutory employment rights (in that case, rights conferred by the Fair Employment and Housing Act (FEHA)), the arbitration will be subject to certain minimal requirements. As we summarized in a subsequent case: "(1) the arbitration agreement may not limit the damages normally available under the statute (*Armendariz, supra*, 24 Cal.4th at p. 103[, 99 Cal.Rptr.2d 745, 6 P.3d 669]); (2) there must be discovery 'sufficient to adequately arbitrate their statutory claim' (*id.* at p. 106[, 99 Cal.Rptr.2d 745, 6 P.3d 669]); (3) there must be a written arbitration decision and judicial review "'sufficient to ensure the arbitrators comply with the requirements of the statute'" (*ibid.*); and (4) the employer must 'pay all types of costs that are unique to arbitration' (*id.* at p. 113[, 99 Cal.Rptr.2d 745, 6 P.3d 669])." (*Little v. Auto Stiegler, Inc.* (2003) 29 Cal.4th 1064, 1076[, 130 Cal.Rptr.2d 892, 63 P.3d 979] (*Little*).) Our imposition of these requirements was based on the recognition that while "a party compelled to arbitrate such rights does not waive them, but merely "'submits to their resolution in an arbitral, rather than a judicial, forum'" [citation], arbitration cannot be misused to accomplish a de facto waiver of these rights." (*Little, supra*, 29 Cal. 4th at p. 1079, 130 Cal.Rptr.2d 892, 63 P.3d 979.) "[T]he above requirements [are] necessary to enable an employee to vindicate . . . unwaivable rights in an arbitration forum." (*Id.* at p. 1077, 130 Cal.Rptr.2d 892, 63 P.3d 979.)

We have not yet considered whether a class arbitration waiver would lead to a de facto waiver of statutory rights, or whether the ability to maintain a class action or arbitration is "necessary to enable an employee to vindicate . . . unwaivable rights in an arbitration forum." (*Little, supra*, 29 Cal.4th at p. 1077, 130 Cal.Rptr.2d 892, 63 P.3d 979.) We conclude that under some circumstances such a provision would lead to a de facto waiver and would impermissibly interfere with employees' ability to vindicate unwaivable rights and to enforce the overtime laws.

In arguing the contrary, Circuit City focuses on the language in *Discover Bank* stating that we were not holding all class action waivers to be necessarily unconscionable, but that waivers in consumer contracts of adhesion involving "predictably . . . small amounts of damages," that are part of a "scheme to deliberately cheat large numbers of consumers out of individually small sums of money," will be held to be unconscionable and unenforceable. (*Discover Bank, supra*, 36 Cal.4th at pp. 162-163, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) Circuit City argues, as the Court of Appeal concluded, that this is not such a case.

Yet the above quoted passage in *Discover Bank* was not intended to suggest that consumer actions involving minuscule amounts of damages were the only actions in which class action waivers would not be enforced. Rather, *Discover Bank* was an application of a more general principle: that although "[c]lass action and arbitration waivers are not, in the abstract, exculpatory clauses" (*Discover Bank, supra*, 36 Cal.4th at p. 161, 30 Cal.Rptr.3d 76, 113 P.3d 1100), such a waiver can be exculpatory in practical terms because it can make it very difficult for those

injured by unlawful conduct to pursue a legal remedy. Gentry argues persuasively that class action waivers in wage and hour cases and overtime cases would have, at least frequently if not invariably, a similar exculpatory effect for several reasons, and would therefore undermine the enforcement of the statutory right to overtime pay.

First, individual awards in wage and hour cases tend to be modest. In addition to the fact that litigation over minimum wage by definition involves the lowest-wage workers, overtime litigation also usually involves workers at the lower end of the pay scale, since professional, executive, and administrative employees are generally exempt from overtime statutes and regulations. (See Cal.Code Regs., tit. 8, § 11070, subd. I(A); *Ramirez v. Yosemite Water Co.* (1999) 20 Cal.4th 785, 798, fn. 4, 85 Cal.Rptr.2d 844, 978 P.2d 2.) According to the DLSE's report in response to Gentry's Public Records Act request, the average award from its wage adjudication unit for 2000-2005 was $6,038. (See also Asian Pacific American Legal Center et al., Reinforcing the Seams: Guaranteeing the Promise of California's Landmark Anti-Sweatshop Law, An Evaluation of Assembly Bill 633 Six Years Later (Sept. 2005) p. 2 [average claim for overtime and minimum wage violations submitted to DLSE ranged from $5,000-$7,000, and settlement ranged from $400-$1,600].)

Indeed, the Court of Appeal in *Bell, supra*, 115 Cal.App.4th 715, 9 Cal.Rptr.3d 544, rejected the argument that even an award as large as $37,000 would be "ample incentive" for an individual lawsuit for overtime pay, and would obviate the need for a class action, pointing to the expense and practical difficulties of such individual suits. "[T]he size of the

average claim in part reflects the accrual of unpaid overtime over the five-year duration of this lawsuit prior to trial. When the complaint was first filed in October 1996, the average claim would have been smaller and a large portion of the claims may not have been reasonably adequate to fund the expense of individual litigation. The length of this litigation in fact underscores the practical difficulties vindicating claims to unpaid overtime. Employees will seldom have detailed personal records of hours worked. Their case ordinarily rests on the credibility of vague recollections and requires them to litigate complex overtime formulas and exemption standards. For current employees, a lawsuit means challenging an employer in a context that may be perceived as jeopardizing job security and prospects for promotion. If the employee files after termination of employment, the costs of litigation may still involve travel expenses and time off from work to pursue the case, and the value of any ultimate recovery may be reduced by legal expenses." (*Id.* at p. 745, 9 Cal.Rptr. 3d 544.)[4]

It is true that section 1194 permits employees to recover reasonable attorney fees if they prevail in an overtime litigation suit. (See *Bell v. Farmers Ins.*

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[4] How much is at issue in Gentry's claim in the present case is unclear. Circuit City contends that the claim must be for over $25,000 because the "unlimited" jurisdiction box was checked on the civil case cover sheet accompanying the complaint. Cases alleging less than $25,000 are considered "limited civil cases." (Code Civ. Proc., § 86, subd. (a)(1).) However, as Gentry points out, cases will be classified as unlimited in jurisdiction if injunctive relief is sought (Code Civ. Proc., § 580, subd. (b)(2)), as Gentry did in the present case. Therefore, the designation of "unlimited jurisdiction" on the cover sheet of the complaint does not inform us of the minimum amount of damages being sought.

Exchange (2001) 87 Cal.App.4th 805, 831, 105 Cal. Rptr.2d 59.) Even assuming that such attorney fees were equally available in arbitration, employees and their attorneys must weigh the typically modest recovery, and the typically modest means of the employees bringing overtime lawsuits, with the risk of not prevailing and being saddled with the substantial costs of paying their own attorneys. Moreover, the award of "reasonable" fees and costs are at the discretion of the trial court. Assuming that the arbitrator had similar discretion, there is still a risk that even a prevailing plaintiff/employee may be undercompensated for such expenses. Given these risks and economic realities, class actions play an important function in enforcing overtime laws by permitting employees who are subject to the same unlawful payment practices a relatively inexpensive way to resolve their disputes. We have acknowledged as much in a case involving overtime litigation similar to that at issue in the present case. ""By establishing a technique whereby the claims of many individuals can be resolved at the same time, the class suit both eliminates the possibility of repetitious litigation and provides small claimants with a method of obtaining redress for claims which would otherwise be too small to warrant individual litigation."" (*Sav-On Drug Stores, supra*, 34 Cal.4th at p. 340, 17 Cal.Rptr.3d 906, 96 P.3d 194.) Although we agree at least in theory with Circuit City that arbitration can be a relatively quick and inexpensive method of dispute resolution, the requirement that numerous employees suffering from the same illegal practice each separately prove the employer's wrongdoing is an inefficiency that may substantially drive up the costs of arbitration and diminish the prospect that the overtime laws will be enforced.

The Court of Appeal in the present case, in upholding the class arbitration waiver, pointed to our discussion in *Discover Bank* of the statement in *Gilmer v. Interstate/Johnson Lane Corp.* (1991) 500 U.S. 20, 32, 111 S.Ct. 1647, 114 L.Ed.2d 26, that a plaintiff's Age Discrimination in Employment Act (ADEA) claim should be arbitrated notwithstanding the lack of classwide relief. "At most, the *Gilmer* court can be understood to mean that a party can still vindicate his or her rights under the ADEA even if no class action remedy is available." (*Discover Bank, supra*, 36 Cal.4th at p. 168, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) In so concluding, we cited an article reporting that the median award for employee age discrimination suits was $269,000. (*Ibid.*) Our discussion of *Gilmer* clearly does not apply to the much more modest awards generally available in overtime compensation cases.

A second factor in favor of class actions for these cases, as noted in *Bell*, is that a current employee who individually sues his or her employer is at greater risk of retaliation. We have recognized that retaining one's employment while bringing formal legal action against one's employer is not "a viable option for many employees." (*Richards v. CH2M Hill, Inc.* (2001) 26 Cal.4th 798, 821, 111 Cal.Rptr.2d 87, 29 P.3d 175; see also *Mullins v. Rockwell Internat. Corp.* (1997) 15 Cal.4th 731, 741, 63 Cal.Rptr.2d 636, 936 P.2d 1246.) *Richards* and *Mullins* involved high-level managerial and professional employees. The difficulty of suing a current employer is likely greater for employees further down on the corporate hierarchy. As one court observed: "'Although there is only plaintiff's suggestion of intimidation in this instance, the nature of the economic dependency involved in the employment relationship is inherently inhibit-

ing.'" (*O'Brien v. Encotech Const. Services, Inc.* (2001) 203 F.R.D. 346, 351.)

Indeed, federal courts have widely recognized that fear of retaliation for individual suits against an employer is a justification for class certification in the arena of employment litigation, even when it was otherwise questionable that the numerosity requirements of rule 23 (Fed. Rules Civ. Proc., rule 23, 28 U.S.C.) were satisfied.[5] (See, e.g., *Mullen v. Treasure Chest Casino, LLC* (5th Cir.1999) 186 F.3d 620, 625 [it is "reasonably presumed" that potential class members still employed by employer "might be unwilling to sue individually or join a suit for fear of retaliation at their jobs"]; see also *Horn v. Associated Wholesale Grocers, Inc.* (10th Cir.1977) 555 F.2d 270, 275; *Arkansas Education Ass'n v. Board of Education of Portland, Ark.* (8th Cir.1971) 446 F.2d 763, 765; *Scott v. Aetna Servs., Inc.* (D.Conn.2002) 210 F.R.D. 261, 267; *Adames v. Mitsubishi Bank, Ltd.* (E.D.N.Y. 1989) 133 F.R.D. 82, 89 ["[s]ince here a number of putative members [of the class] are current employees, the concern for possible employer reprisal action exists and renders the alternative of individual joinder less than practicable"]; *Simmons v. City of Kansas City* (D.Kan.1989) 129 F.R.D. 178, 180; *Slanina v. William Penn Parking Corp.* (W.D.Pa. 1984) 106 F.R.D. 419, 423-424 [indications that if

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[5] "Rule 23(a) states four threshold requirements applicable to all class actions: (1) numerosity (a 'class [so large] that joinder of all members is impracticable'); (2) commonality ('questions of law or fact common to the class'); (3) typicality (named parties' claims or defenses 'are typical . . . of the class'); and (4) adequacy of representation (representatives 'will fairly and adequately protect the interests of the class')." (*Amchem Products, Inc. v. Windsor* (1997) 521 U.S. 591, 613, 117 S.Ct. 2231, 138 L.Ed.2d 689.)

individual joinder were required, "most, if not all, of the current employees will be hesitant to join"].) "[I]t needs no argument to show that fear of economic retaliation might often operate to induce aggrieved employees quietly to accept substandard conditions." (*Mitchell v. Robert DeMario Jewelry, Inc.* (1960) 361 U.S. 288, 292, 80 S.Ct. 332, 4 L.Ed.2d 323.)

Circuit City points out that retaliation by the employer against an employee who files an overtime claim or other wage and hour claims is unlawful under section 98.6.[6] It further points to DLSE reports showing that the number of complaints made pursuant to section 98.6 in the years 2000-2004 ranged from 446 to 808 annually. (See DLSE, Annual Discrimination Complaint Reports, <http://www.dir.ca.gov/dlse/DLSEreports.htm> [as of Aug. 30, 2007].) It argues from these statistics that the enforcement mechanism to sanction such retaliation is working. We agree with Gentry, however, that these statistics are supportive of his position that retaliation against employees for asserting statutory rights under the Labor Code is widespread. Given that retaliation would cause immediate disruption of the employee's life and economic injury, and given that the outcome of the complaint process is uncertain, we do not believe the existence of an anti-retaliation statute and an administrative complaint process undermines Gentry's point that fear of re-

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[6] Section 98.6, subdivision (a) states in pertinent part: "No person shall discharge an employee or in any manner discriminate against any employee or applicant for employment because . . . the employee or applicant for employment has filed a bona fide complaint or claim or instituted or caused to be instituted any proceeding under or relating to his or her rights, which are under the jurisdiction of the Labor Commissioner. . . ."

taliation will often deter employees from individually suing their employers.

Third, some individual employees may not sue because they are unaware that their legal rights have been violated. The New Jersey Supreme Court recently emphasized the notification function of class actions in striking down a class arbitration waiver in a consumer contract: "[W]ithout the availability of a class-action mechanism, many consumer-fraud victims may never realize that they may have been wronged. As commentators have noted, 'often consumers do not know that a potential defendant's conduct is illegal. When they are being charged an excessive interest rate or a penalty for check bouncing, for example, few know or even sense that their rights are being violated.'" (*Muhammad v. County Bank of Rehoboth Beach, Delaware* (2006) 189 N.J. 1, 912 A.2d 88, 100.) Similarly, it may often be the case that the illegal employer conduct escapes the attention of employees. Some workers, particularly immigrants with limited English language skills, may be unfamiliar with the overtime laws. (See Ha, *An Analysis in Critique of KIWA's Reform Efforts in the Los Angeles Korean-American Restaurant Industry* (2001) 8 Asian L.J. 111, 122-123.) Even English-speaking or better educated employees may not be aware of the nuances of overtime laws with their sometimes complex classifications of exempt and non-exempt employees. (See *Ramirez v. Yosemite Water Co., supra*, 20 Cal.4th at pp. 796-798, 85 Cal.Rptr.2d 844, 978 P.2d 2.) The likelihood of employee unawareness is even greater when, as alleged in the present case, the employer does not simply fail to pay overtime but affirmatively tells its employees that they are not eligible for overtime. Moreover, some employees, due to the transient nature of their work,

may not be in a position to pursue individual litigation against a former employer. (*Ansoumana v. Gristede's Operating Corp.* (S.D.N.Y.2001) 201 F.R.D. 81, 86-87.)

For these reasons, a federal district court recently concluded that an arbitration agreement with a class arbitration waiver was inconsistent with the minimum wage and overtime provisions of the federal Fair Labor Standards Act (FLSA). "In this case, the imposition of a waiver of class actions may effectively prevent . . . employees from seeking redress of FLSA violations. The class action provision thereby circumscribes the legal options of these employees, who may be unable to incur the expense of individually pursuing their claims. In this respect, the class action waiver is not only unfair to . . . employees, but also removes any incentive for [the employer] to avoid the type of conduct that might lead to class action litigation in the first instance. The class action clause is therefore substantively unconscionable." (*Skirchak v. Dynamics Research Corp., Inc.* (D.Mass. 2006) 432 F.Supp.2d 175, 181.) Similarly, in another FLSA suit for minimum wage and overtime violations, the trial court stated, interpreting the rule 23(a)(1) requirement that "the proposed class be 'so numerous that joinder of all members is impracticable'": "I also find it fair to consider that the members of this group would not be likely to file individual suits. Their lack of adequate financial resources or access to lawyers, their fear of reprisals (especially in relation to the immigrant status of many), the transient nature of their work, and other similar factors suggest that individual suits as an alternative to a class action are not practical. [Citation.]" (*Ansoumana v. Gristede's Operating Corp.*, *supra*, 201 F.R.D. at pp. 85-86.)

We also agree with the *Bell* court that "class actions may be needed to assure the effective enforcement of statutory policies even though some claims are large enough to provide an incentive for individual action. While employees may succeed under favorable circumstances in recovering unpaid overtime through a lawsuit or a wage claim filed with the Labor Commissioner, a class action may still be justified if these alternatives offer no more than the prospect of 'random and fragmentary enforcement' of the employer's legal obligation to pay overtime." (*Bell, supra,* 115 Cal.App.4th at p. 745, 9 Cal.Rptr.3d 544, quoting *Vasquez, supra,* 4 Cal.3d at p. 807, 94 Cal.Rptr. 796, 484 P.2d 964.) "By preventing 'a failure of justice in our judicial system' (*Linder v. Thrifty Oil Co.*[(2000)] 23 Cal.4th 429, 434[, 97 Cal.Rptr.2d 179, 2 P.3d 27]), the class action not only benefits the individual litigant but serves the public interest in the enforcement of legal rights and statutory sanctions." (*Bell, supra*, at p. 741, 9 Cal. Rptr.3d 544.) In other words, absent effective enforcement, the employer's cost of paying occasional judgments and fines may be significantly outweighed by the cost savings of not paying overtime.

We cannot say categorically that all class arbitration waivers in overtime cases are unenforceable. As Circuit City points out, some 40 published cases over the last 70 years in California have involved individual employees prosecuting overtime violations without the assistance of class litigation or arbitration. (See, e.g., *Ramirez v. Yosemite Water Co., supra*, 20 Cal.4th 785, 85 Cal.Rptr.2d 844, 978 P.2d 2; *Sequeira v. Rincon-Vitova Insectaries, Inc.* (1995) 32 Cal.App.4th 632, 38 Cal.Rptr.2d 264; *Monzon v. Schaefer Ambulance Service, Inc.* (1990) 224 Cal.App.3d 16, 273 Cal.Rptr. 615.) Not all overtime cases will necessarily lend themselves

to class actions, nor will employees invariably request such class actions. Nor in every case will class action or arbitration be demonstrably superior to individual actions.

Nonetheless, when it is alleged that an employer has systematically denied proper overtime pay to a class of employees and a class action is requested notwithstanding an arbitration agreement that contains a class arbitration waiver, the trial court must consider the factors discussed above: the modest size of the potential individual recovery, the potential for retaliation against members of the class, the fact that absent members of the class may be ill informed about their rights, and other real world obstacles to the vindication of class members' right to overtime pay through individual arbitration. If it concludes, based on these factors, that a class arbitration is likely to be a significantly more effective practical means of vindicating the rights of the affected employees than individual litigation or arbitration, and finds that the disallowance of the class action will likely lead to a less comprehensive enforcement of overtime laws for the employees alleged to be affected by the employer's violations, it must invalidate the class arbitration waiver to ensure that these employees can "vindicate [their] unwaivable rights in an arbitration forum." (*Little, supra*, 29 Cal.4th at p. 1077, 130 Cal.Rptr.2d 892, 63 P.3d 979.)[7] The kind of inquiry a trial court must make is

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[7] The dissent claims our holding is inconsistent with *Little's* predecessor, *Armendariz*, because here "[n]o finding is made that a class remedy is *essential*, as a practical matter, to vindication of the 'unwaivable' statutory right" (Dis. opn., *post*, 64 Cal. Rptr.3d at pp. 797-798, 165 P.3d at p. 576.) *Armendariz* did not use the dissent's italicized word "essential" in its formulation, and it is unclear what that word means in this context. Rather,

similar to the one it already makes to determine

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in holding for example that employers must pay most of the costs when they mandate arbitration of unwaivable rights for their employees, we concluded that the imposition of such costs would burden employees' rights by "pos[ing] a significant risk that employees will have to bear large costs to vindicate their statutory right against workplace discrimination." (*Armendariz, supra*, 24 Cal.4th at p. 110, 99 Cal.Rptr.2d 745, 6 P.3d 669.) So, too, in the present case, although it is still possible for employees to individually vindicate their rights to overtime pay, the class arbitration waiver may, practically speaking, significantly burden the ability of employees to do so. *Armendariz* makes clear that for public policy reasons we will not enforce provisions contained within arbitration agreements that pose significant obstacles to the vindication of employees' statutory rights. The Legislature has amended the California Arbitration Act (CAA) several times since *Armendariz* (Stats.2002, ch. 176, § 1; Stats. 2002, ch. 1158, § 1; Stats.2005, ch. 607, § 1; Stats.2006, ch. 357, § 1) but has not overturned or modified the holdings in that case.

Moreover, the dissent's contention that Gentry as an individual has not shown himself to be burdened by the class arbitration waiver is off the mark. First, questions of the value of his claim and the appropriateness of a class arbitration in this case will be determined on remand. More fundamentally, as suggested above, one of the advantages of class action litigation or arbitration is precisely the fact that the class representative spearheading the litigation is in a more advantageous position—e.g., is better informed, is less likely to be intimidated—than the class as a whole, and the class benefits from the representative's advantages. Given this reality, and given that our primary concern is ensuring that the state's overtime laws be effectively enforced and that class arbitration waivers not thwart that enforcement, it makes little sense to focus only on whether the class representative himself or herself would be stymied in the pursuit of an individual arbitration remedy (see dis. opn., *post*, 64 Cal.Rptr.3d at p. 800, 165 P.3d at p. 578), rather than considering as well the difficulties for the class of employees affected by Circuit City's allegedly unlawful practices.

whether class actions are appropriate. "[T]rial courts are ideally situated to evaluate the efficiencies and practicalities of permitting group action. . . ." (*Linder v. Thrifty Oil, Co., supra*, 23 Cal.4th at p. 435, 97 Cal.Rptr.2d 179, 2 P.3d 27.) Class arbitration must still also meet the "community of interest" requirement for all class actions, consisting of three factors: "(1) predominant common questions of law or fact; (2) class representatives with claims or defenses typical of the class; and (3) class representatives who can adequately represent the class." (*Sav-On Drug Stores, supra*, 34 Cal.4th at p. 326, 17 Cal.Rptr.3d 906, 96 P.3d 194.)

Of course, in cases like the present, the trial court would be comparing class arbitration with the individual arbitration methods the employer offers, rather than comparing individual with classwide litigation. We do not foreclose the possibility that there may be circumstances under which individual arbitrations may satisfactorily address the overtime claims of a class of similarly aggrieved employees, or that an employer may devise a system of individual arbitration that does not disadvantage employees in vindicating their rights under section 1194. But class arbitration waivers cannot, consistent with the strong public policy behind section 1194, be used to weaken or undermine the private enforcement of overtime pay legislation by placing formidable practical obstacles in the way of employees' prosecution of those claims.

Circuit City makes a number of arguments that we have already concluded lack merit. As in *Discover Bank*, we again reject the "unsupported assertions [of some courts] that, in the case of small individual recovery, attorney fees are an adequate substitute for

the class action or arbitration mechanism. Nor do we agree . . . that small claims litigation, government prosecution, or informal resolution are adequate substitutes." (*Discover Bank, supra*, 36 Cal.4th at p. 162, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) In particular, we reject Circuit City's argument that the availability of enforcement by the Labor Commissioner is an adequate substitute for classwide arbitration. It is true that an employee may seek administrative relief from overtime violations with the Labor Commissioner through a "Berman" hearing procedure pursuant to sections 98 to 98.8. (Added by Stats.1976, ch. 1190, §§ 4-11, pp. 5368-5371.) But a losing employer has a right to a trial de novo in superior court, where the ruling of the Labor Commissioner's hearing officer is entitled to no deference. (§ 98.2, subds. (b), (c); *Murphy v. Kenneth Cole Productions, Inc.* (2007) 40 Cal.4th 1094, 1116, 56 Cal.Rptr.3d 880, 155 P.3d 284 (*Murphy*).) Thus, Berman hearings may result in no cost savings to the employee. Moreover, in *Bell,* in rejecting the same argument, the court considered a declaration by a former chief counsel of the DLSE, who stated that "'[r]equiring two thousand or so class members to go through individual "Berman" hearings would obviously be extremely inefficient as compared to a single class action. Also, a deluge of claims would simply outstrip the resources of the DLSE . . . impacting not only these claimants but others unrelated to this suit.'" (*Bell, supra*, 115 Cal.App.4th at p. 746, 9 Cal.Rptr.3d 544.) In short, Berman hearings are neither effective nor practical substitutes for class action or arbitration.

Nor do we accept Circuit City's argument that a rule invalidating class arbitration waivers discriminates against arbitration clauses in violation of the

Federal Arbitration Act (FAA; 9 U.S.C. § 1 et seq.). We considered at great length and rejected a similar argument in *Discover Bank*. (*Discover Bank, supra*, 36 Cal.4th at pp. 163-173, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) The principle that in the case of certain unwaivable statutory rights, class action waivers are forbidden when class actions would be the most effective practical means of vindicating those rights is an arbitration-neutral rule: it applies to class waivers in arbitration and nonarbitration provisions alike. (See *AOL, supra*, 90 Cal.App.4th at pp. 17-18, 108 Cal.Rptr.2d 699; see also *Armendariz, supra*, 24 Cal.4th at pp. 99-102, 99 Cal.Rptr.2d 745, 6 P.3d 669 [imposition of minimal requirements on arbitration necessary to vindicate statutory rights not a violation of the FAA].) "The *Armendariz* requirements are . . . applications of general state law contract principles regarding the unwaivability of public rights to the unique context of arbitration, and accordingly are not preempted by the FAA." (*Little, supra*, 29 Cal.4th at p. 1079, 130 Cal.Rptr.2d 892, 63 P.3d 979.) We also continue to reject Circuit City's suggestion that class actions are incompatible with arbitration and that compelling class arbitration in the appropriate case violates the FAA. (*Discover Bank, supra*, 36 Cal.4th at pp. 171-172, 30 Cal.Rptr.3d 76, 113 P.3d 1100.)[6]

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[6] The dissent declares that we "may not elevate a mere judicial affinity for class actions as a beneficial device for implementing the wage laws above the policy expressed by both Congress and our own Legislature that voluntary individual agreements to arbitrate . . . should be enforced according to their terms." (Dis. opn., *post*, 64 Cal.Rptr.3d at pp. 799-800, 165 P.3d at p. 578.) What is at issue in this case, however, is not a "judicial affinity for class actions" but the enforcement of an unwaivable *statutory* right to overtime pay. What happens when a class action waiver significantly interferes with that

right? Although the dissent claims that our concerns about the effect of class arbitration waivers are exaggerated, based on its own questionable assumptions about class arbitration and litigation, it also appears to adopt the position that *even if* we are correct that such waivers will substantially interfere with the ability of employees to enforce overtime laws in some cases, the waiver should nonetheless be given effect. The dissent thus articulates its preference that in this case the statutory policy in favor of enforcing arbitration agreements as written overrides the statutory policy in favor of vigorously enforcing overtime laws.

There is no indication, however, that the Legislature shared or shares the dissent's preference, or even that it has favored the arbitration of wage and overtime claims at all. Indeed, the evidence is to the contrary. Section 1194 provides, as discussed, that an employee is entitled to recover "in a civil action" overtime or minimum wage compensation. It seems doubtful that the Legislature contemplated, when that statute was originnally enacted in 1937 (Stats.1937, ch. 90, § 1194, p. 217), that employer-mandated arbitration could serve as a substitute to "civil actions" authorized by the statute. In fact, the forerunner of the CAA, Code of Civil Procedure former section 1280, in operation at the time section 1194 was originally enacted, specifically excluded "contracts pertaining to labor" from the scope of enforceable arbitration agreements. (Stats.1935, ch. 52, § 9, p. 388.) Moreover, at the time of the CAA's enactment in 1961 (Stats.1961, ch. 461, § 2, p. 1540), the United States Supreme Court's construction of the FAA indicated that arbitration statutes would not be used to enforce agreements to arbitrate unwaivable statutory rights. (See *Wilko v. Swan* (195?) 346 U.S. 427, 435-437, 74 S.Ct. 182, 98 L.Ed. 168, overruled by *Rodriguez de Quijas v. Shearson/Am. Exp.* (1989) 490 U.S. 477, 109 S.Ct. 1917, 104 L.Ed.2d 526.) Outright legislative hostility to arbitrating wage claims was further manifested in Labor Code section 229, passed two years before the CAA went into effect. (Stats.1959, ch. 1939, § 1, p. 4532.) That section, which involves judicial actions to collect unpaid wages, provides that such actions "may be maintained without regard to the existence of any private agreement to arbitrate." Thus, if we can discern any legislative policy toward employee wage claims, it is that employees should have direct access to a judicial forum to

Accordingly, we will remand this case to the Court of Appeal with directions to remand to the trial court to determine in light of the above discussion whether, in this particular case, class arbitration would be a significantly more effective means than individual arbitration actions of vindicating the right to overtime pay of the group of employees whose rights to such pay have been allegedly violated by Circuit City. If the trial court invalidates the waiver on public policy grounds, then the parties may proceed to class arbitration or, if the parties wish, have the matter brought in court (see *Discover Bank, supra*, 36 Cal.4th at p. 173, fn. 8, 30 Cal.Rptr.3d 76, 113 P.3d 1100), unless the trial court invalidates the arbitration agreement altogether for reasons discussed in the next section of this opinion. Generally speaking, when an arbitration agreement contains a single

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enforce their rights. Nor is there any sign that the Congress that enacted the FAA contemplated that it be used to compel arbitration of statutory wage claims. (See Leroy & Feuille, Judicial Enforcement of Predispute Arbitration Agreements: Back to the Future (2003) 18 Ohio St. J. Disp. Resol. 249, 279 [legislative history indicates "Congress's main concern was with businesses who wanted to . . . resolve their commercial disputes privately."].) The United States Supreme Court has since held that the FAA does not permit states to legislatively prohibit arbitration of wage disputes. (*Perry v. Thomas* (1987) 482 U.S. 483, 107 S.Ct. 2520, 96 L.Ed.2d 426.) But both the FAA and the CAA permit arbitration-neutral rules that limit enforcement of specific provisions of arbitration agreements on public policy grounds. (See *Armendariz, supra*, 24 Cal.4th at p. 99, 99 Cal. Rptr.2d 745, 6 P.3d 669; 9 U.S.C. § 2; Code Civ. Proc., § 1281.) It is perfectly consistent with the evident intent of the Legislature to refuse to enforce, under some circumstances and in an arbitration-neutral manner in accord with the FAA and the CAA, provisions of arbitration agreements that significantly undermine the ability of employees to vindicate their statutory right to overtime pay.

term in violation of public policy, that term will be severed and the rest of the arbitration agreement enforced. (*Little, supra*, 29 Cal.4th at pp. 1074-1075, 130 Cal.Rptr.2d 892, 63 P.3d 979.) We believe that severance is particularly appropriate in the case of class arbitration waivers because, unlike limitations on remedies or other limitations that are invalid on their face (see *Armendariz, supra*, 24 Cal.4th at pp. 103-104, 99 Cal.Rptr.2d 745, 6 P.3d 669), such waivers will only be invalidated after the proper factual showing, as discussed above. The presence of a class arbitration waiver in an employee arbitration agreement therefore does not by itself "indicate a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage." (*Id.* at p. 124, 99 Cal.Rptr.2d 745, 6 P.3d 669.)

B. The Opt-out Provision and Procedural Unconscionability

The Court of Appeal concluded, and Circuit City argues, that the fact that an employee had 30 days to opt out of the arbitration agreement means that the terms of the agreement, including the class arbitration waiver, are not procedurally unconscionable and are therefore enforceable. But the validity of a class arbitration waiver was analyzed in the previous part of this opinion in terms of unwaivable statutory rights rather than unconscionability. (See *Armendariz, supra*, 24 Cal.4th at p. 113, 99 Cal.Rptr.2d 745, 6 P.3d 669.) Because the statutory rights under section 1194 at issue in this case are not waivable, the minimal requirements imposed on arbitration agreements to ensure their vindication cannot be waived by the employee in a prelitigation agreement. (*Armendariz, supra*, 24 Cal.4th at p. 103, fn. 8, 99

Cal.Rptr.2d 745, 6 P.3d 669.) As we clarified in *Armendariz*, such waiver could only occur "in situations in which an employer and an employee knowingly and voluntarily enter into an arbitration agreement *after a dispute has arisen.* In those cases, employees are free to determine what trade-offs between arbitral efficiency and formal procedural protections best safeguard their statutory rights. Absent such freely negotiated agreements, it is for the courts to ensure that the arbitration forum imposed on an employee is sufficient to vindicate his or her rights. . . ." (*Ibid.*, italics added.) There was no freely negotiated postdispute agreement, nor for that matter a postdispute agreement of any kind, in the present case. Therefore, if the trial court on remand finds the class arbitration waiver invalid using the factors set forth in the previous part of this opinion, that waiver will not be enforced.[9]

Gentry does challenge provisions of the arbitration agreement other than the class arbitration waiver, however, and argues that the entire arbitration agreement is unconscionable and unenforceable. Should the trial court on remand find the class arbitration waiver in the present case to be void, it is unclear whether the issue of the unconscionability of the arbitration agreement as a whole will become moot, because it is unclear whether Gentry will continue to resist arbitration or whether Circuit City will continue to seek it. Nonetheless, because this issue may remain viable on remand, we will address

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[9] We note that if an employee believes individual arbitration to be as advantageous as the dissent suggests, nothing in this opinion, nor in any subsequent trial court ruling, precludes him or her from entering into an individual postdispute arbitration agreement with Circuit City.

the Court of Appeal's holding that the arbitration agreement was not unconscionable because Gentry had a 30-day period to opt out of the agreement. As noted above, the Court of Appeal stated that because of the opt-out provision, "the agreement at issue here does not have [an] adhesive element and therefore is not procedurally unconscionable."

As a threshold matter, Gentry argues that the arbitration agreement was ineffective because his failure to opt out of the agreement cannot constitute assent to that agreement. Gentry bases his argument on the well-established principle "that an offeror has no power to cause the silence of the offeree to operate as an acceptance when the offeree does not intend it to do so." (1 Corbin on Contracts (rev. ed.1993) § 3.19, p. 407.) As one court cited in the above treatise has stated: "'[W]here the recipient of an offer is under no duty to speak, silence, when not misleading, may not be translated into acceptance merely because the offer purports to attach that effect to it. [Citations.]'" (*Albrecht Chemical Co. v. Anderson Trading Corp.* (1949) 298 N.Y. 437, 84 N.E.2d 625, 626; see also *Leslie v. Brown Brothers Incorporation* (1929) 208 Cal. 606, 621, 283 P. 936.) On the other hand, silence can constitute acceptance when "the conduct of the party denying a contract has been such as to lead the other reasonably to believe that silence, without communication, would be sufficient" to create a contract. (1 Corbin on Contracts, *supra*, § 3.21, p. 414.)

In this case, Gentry signed an easily readable, one-page form that accompanied receipt of the Associate Issue Resolution Package. The form stated in part: "I understand that participation in the Issue Resolution Program is voluntary. If I do not wish to

participate in the arbitration component of the Program, however, I must send the completed 'Circuit City Arbitration Opt-Out Form,' which is included with this package. I must send the Opt-Out Form via U.S. mail . . . to the above address within **30 calendar days** of the date on which I signed below. I understand that if I do not mail the Form within 30 calendar days, I will be required to arbitrate all employment-related legal disputes I may have with Circuit City."(Original boldface.)

Although Gentry contends his signature was merely an acknowledgement of receipt of the Associate Issue Resolution Package, it was also an acknowledgment of his assent to the opt-out provision. The opt-out provision of the acknowledgment agreement was neither inconspicuous or difficult to understand. Thus, in signing the above form, Gentry manifested his intent to use his silence, or failure to opt out, as a means of accepting the arbitration agreement. Having thus indicated his intent, he may not now claim that the failure to opt out did not constitute acceptance of the arbitration agreement. (1 Corbin on Contracts, *supra,* § 3.21, p. 414.) The question is not whether the acknowledgement form itself is a valid contract—it is not—but rather whether Gentry's signature on that form reasonably led Circuit City to believe that his failure to opt out constituted acceptance of the arbitration agreement. We conclude under the circumstances of this case that it did.

The question whether an arbitration agreement has been validly formed is of course different from whether that agreement was unconscionable. In order to evaluate the Court of Appeal's conclusion that the 30-day opt-out provision meant that Circuit City's arbitration agreement was not procedurally

unconscionable, we first review some general principles. "'To briefly recapitulate the principles of unconscionability, the doctrine has "'both a "procedural" and a "substantive" element,' the former focusing on "'oppression'" or "'surprise'" due to unequal bargaining power, the latter on "'overly harsh'" or "'one-sided'" results." [Citation.] The procedural element of an unconscionable contract generally takes the form of a contract of adhesion, "'which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.'" . . . [¶] Substantively unconscionable terms may take various forms, but may generally be described as unfairly one-sided.'" (*Discover Bank, supra*, 36 Cal.4th at p. 160, 30 Cal.Rptr.3d 76, 113 P.3d 1100.)

As we have further explained: "'The prevailing view is that [procedural and substantive unconscionability] must both be present in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability.' [Citation.] But they need not be present in the same degree. 'Essentially a sliding scale is invoked which disregards the regularity of the procedural process of the contract formation, that creates the terms, in proportion to the greater harshness or unreasonableness of the substantive terms themselves.' [Citations.] In other words, the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa." (*Armendariz, supra*, 24 Cal.4th at p. 114, 99 Cal. Rptr.2d 745, 6 P.3d 669, italics omitted.)

As the above suggests, a finding of procedural unconscionability does not mean that a contract will not be enforced, but rather that courts will scrutinize the substantive terms of the contract to ensure they are not manifestly unfair or one-sided. (See, e.g., *Little, supra*, 29 Cal.4th at p. 1071, 130 Cal.Rptr.2d 892, 63 P.3d 979.) As also suggested above, there are degrees of procedural unconscionability. At one end of the spectrum are contracts that have been freely negotiated by roughly equal parties, in which there is no procedural unconscionability. Although certain terms in these contracts may be construed strictly, courts will not find these contracts substantively unconscionable, no matter how one-sided the terms appear to be. (See, e.g., *Nunes Turfgrass, Inc. v. Vaughan-Jacklin Seed Co.* (1988) 200 Cal.App.3d 1518, 1538-1539, 246 Cal.Rptr. 823 [liability limitation negotiated by two commercial entities upheld].) Contracts of adhesion that involve surprise or other sharp practices lie on the other end of the spectrum. (See, e.g., *Ellis v. McKinnon Broadcasting Co.* (1993) 18 Cal. App.4th 1796, 1804, 23 Cal.Rptr.2d 80 [party told that signing contract was "mere formality" to conceal oppressive forfeiture provision].) Ordinary contracts of adhesion, although they are indispensable facts of modern life that are generally enforced (see *Graham v. Scissor-Tail, Inc.* (1981) 28 Cal.3d 807, 817-818, 171 Cal.Rptr. 604, 623 P.2d 165), contain a degree of procedural unconscionability even without any notable surprises, and "bear within them the clear danger of oppression and overreaching." (*Id.*, at p. 818, 171 Cal.Rptr. 604, 623 P.2d 165.)

Thus, a conclusion that a contract contains no element of procedural unconscionability is tantamount to saying that, no matter how one-sided the contract terms, a court will not disturb the contract

because of its confidence that the contract was negotiated or chosen freely, that the party subject to a seemingly one-sided term is presumed to have obtained some advantage from conceding the term or that, if one party negotiated poorly, it is not the court's place to rectify these kinds of errors or asymmetries. Accordingly, if we take the Court of Appeal in this case at its word that there was no element of procedural unconscionability in the arbitration agreement because of the 30-day opt-out provision, then the logical conclusion is that a court would have no basis under common law unconscionability analysis to scrutinize or overturn even the most unfair or exculpatory of contractual terms.

We conclude that the Court of Appeal erred in finding the present agreement free of procedural unconscionability. It is true that freedom to choose whether or not to enter a contract of adhesion is a factor weighing against a finding of procedural unconscionability. (See, e.g., *Dean Witter Reynolds, Inc. v. Superior Court* (1989) 211 Cal.App.3d 758, 769-771, 259 Cal.Rptr. 789 [agreement between brokerage house and sophisticated consumer of financial services that included a $50 termination fee on an IRA account was not unconscionable where competing IRA's without the challenged fee were freely available].) But there are several indications that Gentry's failure to opt out of the arbitration agreement did not represent an authentic informed choice.

First and foremost, the explanation of the benefits of arbitration in the Associate Issue Resolution Handbook was markedly one-sided. The Court of Appeal thought otherwise, stating: "The 'Associate Issue Resolution Handbook,' written in straightforward language, does point out the advantages of

electing arbitration (notably, that the procedure is cost effective and the employee's claim is resolved 'in a matter of weeks or a few months rather than years'). However, it also notes the disadvantages (for example, the lack of a right to a jury trial and limited discovery). The employee is then free to decide whether or not the advantages of arbitration outweigh the disadvantages."

But what the Court of Appeal's discussion entirely neglected is that although the handbook alluded to some of the shortcomings of arbitration in the general sense, it did not mention any of the additional significant disadvantages that *this particular arbitration agreement* had compared to litigation. These included the following: First, the agreement provided for a one-year statute of limitations as opposed to the three-year statute for recovering overtime wages provided under Code of Civil Procedure section 338 (see *Murphy, supra,* 40 Cal.4th at p. 1099, 56 Cal.Rptr.3d 880, 155 P.3d 284) and a four-year statute of limitations for the unfair competition claim under Business and Professions Code section 17208. Second, the agreement provided a limitation of remedies to backpay "only up to one year from the point at which the [employee] knew or should have known of the events giving rise to the alleged violation of the law," whereas an employee filing suit could potentially recover backpay for a three-year period from the date the cause of action actually accrued. Third, the agreement imposed a maximum of $5,000 in punitive damages. Although exemplary damages are not available in overtime suits (see § 1194.2 ["liquidated damages" equal to the amount of wages recovered available in minimum wage litigation but not overtime litigation]), Circuit City's agreement applied to "any and all employment-related legal disputes,"

including violation of the FEHA and discharges in violation of public policy, for which punitive damages without any such limitation would be available. (See *Commodore Home Systems, Inc. v. Superior Court* (1982) 32 Cal.3d 211, 220-221, 185 Cal.Rptr. 270, 649 P.2d 912.) Fourth, the agreement contained a provision that parties will "generally" be liable for their own attorney fees, with the arbitrator having the "discretion" to award the employee attorney fees, as opposed to section 1194's provision that a prevailing employee "is entitled to" reasonable attorney fees and costs. (§ 1194, subd. (a).)

The fact that Circuit City's explanation of the arbitration agreement emphasized that the arbitration is "much less expensive" and that "the arbitrator can award monetary damages to compensate you for the harm you may have suffered," without mentioning the many disadvantages to the employee that Circuit City had inserted into the agreement, meant that the employee would receive a highly distorted picture of the arbitration Circuit City was offering. Although an employee who read Circuit City's nine-page single-spaced document entitled Circuit City's "Dispute Resolution Rules and Procedures" would have encountered the above provisions, only a legally sophisticated party would have understood that these rules and procedures are considerably less favorable to an employee than those operating in a judicial forum. As has been observed, even "'experienced but legally unsophisticated businessmen may be unfairly surprised by unconscionable contract terms.'" *(Stirlen v. Supercuts, Inc.* (1997) 51 Cal.App.4th 1519, 1535, 60 Cal.Rptr.2d 138 [finding unconscionability in a corporate manager's arbitration agreement with his employer].) The same would be even more true for the nonexecutive employees who would be the likely

plaintiffs in suits about overtime pay. And notwithstanding the statement in the documents provided Gentry that employees "may consult with an attorney" about their legal rights, and contrary to the dissenting opinion's contention otherwise, it is unrealistic to expect anyone other than higher echelon employees to hire an attorney to review what appears to be a routine personnel document.

Moreover, it is not clear that someone in Gentry's position would have felt free to opt out. The materials provided to Gentry made unmistakably clear that Circuit City preferred that the employee participate in the arbitration program. The "Associate Issue Resolution Handbook" distributed with the opt-out form touted the virtues of arbitration, including use of the all-caps subheading—WHY ARBITRATION IS RIGHT FOR YOU AND CIRCUIT CITY—that left no doubt about Circuit City's preference. The fact that the arbitration agreement was structured so that arbitration was the default dispute resolution procedure from which the employee had to opt out underscored Circuit City's pro-arbitration stance. Given the inequality between employer and employee and the economic power that the former wields over the latter (see *Armendariz, supra*, 24 Cal.4th at p. 115, 99 Cal.Rptr.2d 745, 6 P.3d 669), it is likely that Circuit City employees felt at least some pressure not to opt out of the arbitration agreement. The lack of material information about the disadvantageous terms of the arbitration agreement, combined with the likelihood that employees felt at least some pressure not to opt out of the arbitration agreement, leads to the conclusion that the present agreement

was, at the very least, not entirely free from procedural unconscionability.[10]

To reiterate, the fact that some degree of procedural unconscionability is present does not mean necessarily that the arbitration agreement is unenforceable. But it does mean that the agreement is not immune from judicial scrutiny to determine whether or not its terms are so one-sided or oppressive as to be substantively unconscionable.

As noted, Gentry argues that several provisions of the arbitration agreement other than the class arbitration waiver are substantively unconscionable, an argument that Circuit City disputes. The Court of Appeal did not address these arguments, believing the agreement not to be procedurally unconscionable and upholding the class arbitration waiver. As stated in the previous part of this opinion, we remand the matter to the Court of Appeal with directions to remand to the trial court to determine whether the class arbitration waiver is void. Unless the issue is mooted, the trial court must also determine on remand whether the original 1995 arbitration agreement or an amended agreement controls the present case and whether the controlling agreement has

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[10] We note that two Ninth Circuit cases came to the contrary conclusion. (*Circuit City Stores, Inc. v. Ahmed* (9th Cir.2002) 283 F.3d 1198; *Circuit City Stores, Inc. v. Najd* (9th Cir.2002) 294 F.3d 1104.) The *Ahmed* court in its brief discussion of the unconscionability issue did not consider the concealment of disadvantageous terms nor the reality that Circuit City clearly favored arbitration and was in a position to pressure employees to choose its favored option. (*Ahmed, supra*, 283 F.3d at pp. 1199-1200.) *Najd* viewed *Ahmed* as binding. (*Najd, supra*, 294 F.3d at p. 1108.) We find neither case persuasive.

substantively unconscionable terms.[11] If so, the court must determine whether these terms should be severed, or whether instead the arbitration agreement as a whole should be invalidated. (See *Little, supra*, 29 Cal.4th at pp. 1074-1076, 130 Cal.Rptr.2d 892, 63 P.3d 979.)

III. DISPOSITION

The judgment of the Court of Appeal is reversed and the cause is remanded for proceedings consistent with this opinion.

WE CONCUR: GEORGE, C.J., KENNARD, and WERDEGAR, JJ.

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[11] Circuit City points to a 1998 modification of the arbitration agreement that required that the arbitration be conducted according to the procedural rules in effect when the arbitration request was filed. Circuit City further points to the arbitration agreement amendments of 2001 and 2005, which it claims do not contain the above terms, and contends that these amended agreements would govern the conduct of Gentry's arbitration and are not substantively unconscionable. Gentry on the other hand argues that the 1995 rules apply and that for various reasons the 1998 amendment is not effective. The Court of Appeal did not address this issue, nor was it one of the issues presented in the petition for review. Assuming the issue is not moot, it must be determined on remand which agreement controls and whether there is substantive unconscionability under that agreement. But for present purposes, our only inquiry is whether the 1995 arbitration agreement, notwithstanding its opt-out provision, contained an element of procedural unconscionability. The fact that the 1995 agreement had substantively unconscionable terms that were not fully disclosed to Gentry is directly pertinent to that determination.

Dissenting Opinion by BAXTER, J.

I respectfully dissent. I cannot join the majority's continuing effort to limit and restrict the terms of private arbitration agreements, which enjoy special protection under both state and federal law.

Both the Federal Arbitration Act (FAA; 9 U.S.C. § 1 et seq.) and the California Arbitration Act (CAA; Code Civ. Proc., § 1281 et seq.) provide that an agreement to resolve disputes by arbitration, rather than by court litigation, must be enforced except upon grounds applicable to contracts generally. These statutes are intended to override courts' historical suspicion of arbitration as an inferior forum for the vindication of claims, and to endorse contracts—including employment contracts—in which parties agree to resolve their disputes by this relatively cheap, simple, and expeditious means. (See, e.g., *Circuit City Stores, Inc. v. Adams* (2001) 532 U.S. 105, 111-124, 121 S.Ct. 1302, 149 L.Ed.2d 234; *Gilmer v. Interstate/Johnson Lane Corp.* (1991) 500 U.S. 20, 30, 111 S.Ct. 1647, 114 L.Ed.2d 26 (*Gilmer*); *Moses H. Cone Hospital v. Mercury Constr. Corp.* (1983) 460 U.S. 1, 24, 103 S.Ct. 927, 74 L.Ed.2d 765 (*Moses H. Cone Hospital*); *St. Agnes Medical Center v. PacifiCare of California* (2003) 31 Cal.4th 1187, 1204, 8 Cal. Rptr.3d 517, 82 P.3d 727; *Mercury Ins. Group v. Superior Court* (1998) 19 Cal.4th 332, 342, 79 Cal.Rptr.2d 308, 965 P.2d 1178; *Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1, 9, 10 Cal.Rptr.2d 183, 832 P.2d 899.)[1]

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[1] Section 2 of the FAA (9 U.S.C. § 2) creates "a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." (*Moses H. Cone Hospital, supra*, 460 U.S. 1, 24, 103 S.Ct. 927.)

In all but the most exceptional cases, these laws thus demand deference to the "*fundamentally contractual nature* [of private arbitration], and to the attendant requirement that [contractual] arbitration shall proceed *as the parties themselves have agreed.* [Citation.]" (*Vandenberg v. Superior Court* (1999) 21 Cal.4th 815, 831, 88 Cal.Rptr.2d 366, 982 P.2d 229, first italics added; see, e.g., *Volt Info. Sciences v. Leland Stanford Jr. U.* (1989) 489 U.S. 468, 478, 109 S.Ct. 1248, 103 L.Ed.2d 488 [FAA "requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms"].) Of course, "by agreeing to arbitrate, a party 'trades the procedures and opportunity for review in the courtroom for the simplicity, informality, and expedition of arbitration.' [Citation.]" (*Gilmer, supra*, 500 U.S. 20, 31, 111 S.Ct. 1647.)

Because of the statutory preference that arbitration agreements be fully implemented, past decisions have recognized but limited circumstances in which general contract principles may render terms of such an agreement unenforceable. The majority holds that such circumstances may be present here. In my view, the majority thereby errs.

Real party in interest Circuit City Stores, Inc. (Circuit City) offered its employees, including plaintiff Gentry, a *voluntary* program to resolve disputes by arbitration. Consistent with the primary advantage of arbitration as a quicker, simpler, and cheaper alternative to court litigation, the program provided, among other things, that claims would proceed on an individual basis, and that consolidation of the separate claims of multiple plaintiffs in a single proceeding would not be permitted.

The program's terms, including the individual arbitration provision, were set forth in a package of written materials, which plaintiff Gentry received, and were further explained in a video presentation, which he attended. He signed a receipt for the written materials. The receipt advised that he should review the materials and contact Circuit City with any questions. It even suggested that he could consult with an attorney about his legal rights. Finally, it clearly provided that, having done so, he could "opt out" of the arbitration program, without penalty, by mailing the appropriate form to Circuit City within 30 days.

Gentry did not exercise his option. The majority concedes that a contract under the program's terms was thus validly formed.

Later, contrary to those provisions, Gentry filed a class action against Circuit City, seeking overtime wages allegedly due both to himself and to other employees. The superior court enforced the arbitration agreement according to its terms, and ordered individual arbitration of Gentry's claim. The Court of Appeal summarily denied mandate. We directed that court to reconsider under the intervening decision in *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148, 30 Cal.Rptr.3d 76, 113 P.3d 1100 (*Discover Bank*). After doing so, the Court of Appeal again denied Gentry relief.

Now the majority reverses, finding that the individual-arbitration term in Circuit City's agreement with Gentry may be invalid. The majority does not reach this result—because it cannot—by any analysis to be found in the prior case law. No finding is made that a class remedy is *essential*, as a practical matter, to vindication of the "unwaivable" statutory right

(*Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, 100-113, 99 Cal.Rptr. 2d 745, 6 P.3d 669 (*Armendariz*); see *Green Tree Financial Corp.-Ala. v. Randolph* (2000) 531 U.S. 79, 90-91, 121 S.Ct. 513, 148 L.Ed.2d 373) to overtime wages. Nor does the majority rely, for this holding, on the public policy against contract terms that are both procedurally and substantively oppressive, and thus "unconscionable." (See *Gilmer, supra*, 500 U.S. 20, 33, 111 S.Ct. 1647; *Armendariz, supra*, at pp. 113-121, 99 Cal.Rptr.2d 745, 6 P.3d 669; but cf. discussion, *post.*)

Finally, there is no suggestion that the individual-arbitration clause in the voluntary agreement between Gentry and Circuit City meets the test of invalid "exculpatory" agreements (see Civ.Code, § 1668) set forth in *Discover Bank, supra,* 36 Cal.4th 148, 30 Cal.Rptr.3d 76, 113 P.3d 1100. There we confronted an agreement, unilaterally imposed by means of a "bill stuffer," that required customers of a credit card company to either accept nonclass arbitration of claims against the company or cease using their accounts. The *Discover Bank* majority held that a waiver of class rights, contained in such a mandatory contract, may be deemed exculpatory, and thus unenforceable, in a setting where "disputes between the contracting parties [will] predictably involve small amounts of damages, and . . . it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of [persons] out of individually small sums of money." (*Id.*, at pp. 162-163, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) Under such circumstances, the majority reasoned, the waiver of class treatment "becomes in practice the exemption of the party [with superior bargaining power] 'from responsibility for

[its] own fraud, or willful injury to the person or property of another.' [Citation.]" (*Id.*, at p. 163, 30 Cal.Rptr.3d 76, 113 P.3d 1100.)

Whatever the merits of *Discover Bank*—a decision from which I largely dissented—we face no similar situation here. As the instant majority admits, claims for overtime wages, unlike the minor credit card fees and charges at issue in *Discover Bank*, are not necessarily and predictably "miniscule" (maj. opn., *ante*, 64 Cal.Rptr.3d at p. 782, 165 P.3d at p. 564), such that the incentive to prosecute individual actions, and thus to hold the wrongdoer to account, will rarely, if ever, be present. Obviously, an individual claim for accumulated unpaid wages can be substantial. And there is no indication in the record that Gentry himself—the person whose contract for individual arbitration is actually before us—cannot, as a practical matter, vindicate his statutory overtime rights except through class proceedings.

Moreover, as the instant majority acknowledges, Circuit City did not abruptly impose on Gentry a mandatory requirement of individual arbitration. Unlike the credit card customers in *Discover Bank*, Gentry was given the opportunity to consider the terms of Circuit City's arbitration proposal, and, after doing so, to opt out of the arbitration program without suffering any penalty or sanction.

Nonetheless, breaking new ground, the majority opines that, for several reasons, an agreement to arbitrate disputes on an individual basis might make it "very difficult" (maj. opn., *ante*, 64 Cal.Rptr.3d at pp. 782-783, 165 P.3d at p. 564) for *some* Circuit City employees to pursue their unwaivable rights to unpaid overtime wages. To that extent, the majority reasons, such a provision—even, apparently, if nei-

ther oppressive nor mandatory—must thus be considered exculpatory and invalid. Accordingly, the majority rules that if, on remand, the trial court decides a representative action is a *significantly better* means of enforcing the statutory rights of *all* affected Circuit City employees to unpaid overtime wages, the court may, at Gentry's behest, ignore and dishonor *his* agreement to arbitrate on an individual basis.

In effect, the majority holds that, despite such an agreement, the trial court may certify a class, in an overtime-wage case, *in any circumstance where it could otherwise do so.* For all practical purposes, the majority thus decrees, such agreements are forbidden, and meaningless, in this context.[2]

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[2] The majority denies that class action waivers in arbitration agreements are *necessarily* invalid in suits to vindicate overtime-wage rights, but that is the practical effect of the majority's holding. Even where no class action waiver is at issue, "[a] line of California cases follows the principle of rule 23(b)(3) of the Federal Rules of Civil Procedure (28 U.S.C.), which 'provides that, for a class action to be maintained, it must be "superior to other available methods for the fair and efficient adjudication of the controversy." This "superiority" criterion has been held to be "manifest" in the . . . requirement that the class mechanism confer "substantial benefits."' [Citations.]" (*Bell v. Farmers Ins. Exchange* (2004) 115 Cal.App.4th 715, 741, 9 Cal.Rptr.3d 544 (*Bell*); see also, e.g., *Linder v. Thrifty Oil Co.* (2000) 23 Cal.4th 429, 435, 97 Cal.Rptr.2d 179, 2 P.3d 27 (*Linder*); *Blue Chip Stamps v. Superior Court* (1976) 18 Cal.3d 381, 385, 134 Cal.Rptr. 393, 556 P.2d 755.) Thus, the majority holds in effect that whenever, in an overtime-wage case, the court could otherwise find a class proceeding appropriate, it may do so notwithstanding a free and fair agreement for individual arbitration. Nor is there any realistic limitation in the majority's suggestion that its rule applies to cases where "systematic[ ]" denial of overtime pay to a "class of employees" is alleged. (Maj. opn.,

The majority cites no currently valid statutory provision that requires or supports such a determination.[3] On the other hand, two statutes—the FAA and the CAA—strongly undermine it. I conclude that the majority may not elevate a mere judicial affinity for class actions as a beneficial device for implementing the wage laws above the policy expressed by both

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ante, 64 Cal.Rptr.3d at pp. 786-787, 165 P.3d at p. 567.) Such assertions would appear, by necessity, in any complaint seeking to litigate overtime-pay claims in a class proceeding.

[3] California statutes generally permit class actions (Code Civ. Proc., § 382) and give workers the right to engage in concerted activities with respect to workplace issues, free of employer interference or coercion (see Lab.Code, § 923), but nothing suggests these laws preclude noncoercive agreements between employer and employee to arbitrate disputes on an individual basis.

As evidence of the Legislature's hostility to the use of contractual arbitration to vindicate wage claims, the majority points to several California statutes that purported to render arbitration agreements unenforceable in this context. (Maj. opn., *ante*, 64 Cal.Rptr.3d at p. 789, fn. 8, 165 P.3d at p. 569, fn. 8.) Of course, as the majority implicitly concedes, all such laws have been *superseded or invalidated* by the prevailing public policy that *favors* enforcement of arbitration agreements according to their terms, as set forth in the CAA and the FAA. (See *Perry v. Thomas* (1987) 482 U.S. 483, 107 S.Ct. 2520, 96 L.Ed.2d 426 [FAA preempted California statute (Lab.Code, § 229) that allowed maintenance of action for unpaid wages "without regard to the existence of any private agreement to arbitrate"].)

On the other hand, as the majority is well aware, the Legislature knows how to provide for a right to class action relief that cannot be waived. It has made such provision, for example, in the Consumers Legal Remedies Act. (Civ.Code, §§ 1751, 1752, 1781; see *Discover Bank*, *supra*, 36 Cal.4th 148, 158-159, 30 Cal.Rptr.3d 76, 113 P.3d 1100; maj. opn., *ante*, 64 Cal.Rptr.3d at p. 780, 165 P.3d at p. 562.) No similar provisions appear in the wage laws at issue here.

Congress and our own Legislature that voluntary individual agreements to arbitrate—by which parties *give up* certain litigation rights and procedures *in return for* the relative speed, informality, and cost efficiency of arbitration—should be enforced according to their terms. Hence, I cannot accept the majority's reasoning, or its result.

In the majority's view, several factors suggest that the absence of a class remedy might "under some circumstances" unduly interfere with employees' ability to vindicate their statutory rights to overtime pay. (Maj. opn., *ante,* 64 Cal.Rptr.3d at p. 782, 165 P.3d at pp. 563-564.) Because claims for unpaid overtime wages tend to be "modest," the majority asserts, the fees and costs of proceeding individually might discourage many such actions, resulting in mere ""random and fragmentary enforcement"" of the wage laws. (*Id.*, 64 Cal.Rptr.3d at p. 787, 165 P.3d at p. 567.) The majority cites the prospect of employer retaliation—admittedly illegal—against a worker who asserts an individual claim without the protective coloration of collective action. An additional issue, the majority suggests, is that many employees, especially those low-wage workers most vulnerable to violations, may not know their rights. Finally, the majority concludes, administrative proceedings—so-called Berman hearings (Lab.Code, §§ 98-98.8; see *Murphy v. Kenneth Cole Productions, Inc.* (2007) 40 Cal.4th 1094, 1114-1116, 56 Cal. Rptr.3d 880, 155 P.3d 284)—are an inadequate alternative means of vindicating smaller claims for overtime wages.

In many respects, the majority's concerns are exaggerated. Though a credit card customer might not sue individually to recover a minor fee or charge he

believes improper, one would expect an employee vigorously to pursue any significant amount due as compensation for his labor. The case law supports that hypothesis. As the majority acknowledges, "some 40 published cases over the last 70 years in California have involved individual employees prosecuting overtime violations without the assistance of class litigation or arbitration. [Citations.]" (Maj. opn., *ante*, 64 Cal.Rptr.3d at p. 787, 165 P.3d at p. 567.)[4]

And though the majority stresses the drawbacks of individual *litigation* to resolve small or modest claims (see generally, e.g., *Linder supra*, 23 Cal.4th 429, 435, 97 Cal.Rptr.2d 179, 2 P.3d 27; *Bell, supra*, 115 Cal.App.4th 715, 741, 9 Cal.Rptr.3d 544), it fails to consider that because arbitration is relatively quick, simple, informal, and inexpensive, it may allow the individual pursuit of claims that would be less practical if litigated individually in court. These qualities of informality, simplicity, and expedition—advantages largely negated by the complexities of a class proceeding—are presumably what Gentry and Circuit City sought when they agreed to individual arbitration.

Moreover, while collective action has its place, the parties here may also have contemplated that

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[4] In the modern era, these cases include *Ramirez v. Yosemite Water Co.* (1999) 20 Cal.4th 785, 85 Cal.Rptr.2d 844, 978 P.2d 2; *Rawson v. Tosco Refining Co.* (1997) 57 Cal.App.4th 1520, 67 Cal.Rptr.2d 790; *Sequeira v. Rincon-Vitova Insectaries, Inc.* (1995) 32 Cal.App.4th 632, 38 Cal.Rptr.2d 264; *Monzon v. Schaefer Ambulance Service, Inc.* (1990) 224 Cal.App.3d 16, 273 Cal.Rptr. 615; *Baker v. Aubry* (1989) 216 Cal.App.3d 1259, 265 Cal.Rptr. 381; *Hernandez v. Mendoza* (1988) 199 Cal.App.3d 721, 245 Cal.Rptr. 36; *Swepston v. State Personnel Bd.* (1987) 195 Cal.App.3d 92, 240 Cal.Rptr. 470; and *Markman v. County of Los Angeles* (1973) 35 Cal.App.3d 132, 110 Cal.Rptr. 610.

resolution of a dispute by the relatively simple, informal process of individual arbitration would reduce the workplace tensions that might otherwise arise as the result of a class battle in court. Indeed, though the majority suggests that class proceedings may lessen the chances of retaliation against an individual employee, I find it hard to imagine that a worker who organizes fellow employees to mount a class assault against the employer will thereby achieve improved standing in the employer's eyes.

But even if class relief were a "significantly more effective" way for Circuit City employees, as a group, to establish their overtime-wage claims (maj. opn., *ante*, 64 Cal.Rptr.3d at pp. 777, 787, 788, 165 P.3d at pp. 559, 567, 568), this does not justify invalidating *Gentry's* voluntary agreement to resolve *his* claims by individual arbitration. Unless Gentry's contract to arbitrate individually constitutes a de facto waiver of *his own* statutory rights, he should not be allowed to act, contrary to his agreement, as a representative plaintiff.[5] Otherwise, the strong public policy that arbitration agreements are to be enforced according to their terms should prevail.

Here, as in *Discover Bank*, the majority insists its analysis does not discriminate against the arbitral forum—an approach forbidden by both the FAA and the CAA—but simply indicates the procedures

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[5] As I have indicated in the text, such a finding cannot be made on this record under the standards suggested by the majority. There is no indication that Gentry's own claim is too small to warrant individual legal action. He need not fear retaliation as a Circuit City employee, because his employment ended in March 2001, before he filed this lawsuit in August 2002. Moreover, the very fact that he sued indicates he was, and is, aware of his legal rights.

necessary in any forum to prevent the de facto waiver of statutory rights. However, there is more than one way courts can show hostility to arbitration as a simpler, cheaper, and less formal alternative to litigation. They can simply refuse to enforce the parties' agreement to arbitrate. Or, more subtly, they can alter the arbitral terms to which the parties agreed, and defeat the essential purposes and advantages of arbitration, by transforming that process, against the parties' expressed will at the time they entered the agreement, into something more and more like the court litigation arbitration is intended to avoid.

Given the strong policy that arbitration agreements are to be enforced as written, any such alteration should be employed only on a showing of the starkest necessity. The majority has not adhered to that limitation here.

Two years ago, I noted that "the [strong prevailing weight] of decisions, applying federal law or the law of other states, . . . hold[s] that arbitration clauses are not invalid either because they specifically exclude class treatment or because they preclude such treatment by failing expressly to provide for it. [Citations.]" (*Discover Bank, supra*, 36 Cal.4th 148, 176, fn. 1, 30 Cal.Rptr.3d 76, 113 P.3d 1100 (conc. & dis. opn. of Baxter, J.).) The majority does not suggest, and I have no reason to believe, that this situation has changed.[6] The majority thus moves

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[6] *Skirchak v. Dynamics Research Corp., Inc.* (D.Mass.2006) 432 F.Supp.2d 175, the only overtime case cited by the majority in which a class waiver in an arbitration provision was invalidated, involved a mandatory agreement unilaterally imposed by the employer. In *Skirchak*, employees were advised by e-mail that they would be required to submit to the company's dispute resolution program. Acceptance was a condition of continued

California further along the path away from the mainstream on the issue. Persuasive reasoning supports the contrary, prevailing view. I must therefore disassociate myself from the majority's holding.

In a separate ruling, the majority concludes that the arbitration agreement between Gentry and Circuit City is procedurally unconscionable, thus exposing numerous other provisions of the agreement to possible invalidation on grounds that they are substantively oppressive or unfair. (See, e.g., *Armendariz, supra,* 24 Cal.4th 83, 114, 99 Cal.Rptr.2d 745, 6 P.3d 669.) Again, I cannot agree.

As noted above, this was not a case in which one party has simply imposed mandatory contract terms on another. Gentry was not required blindly to accept the arbitration program and its terms as a condition of his employment. (Cf. *Little v. Auto Stiegler, Inc.* (2003) 29 Cal.4th 1064, 1071, 130 Cal.Rptr.2d 892, 63 P.3d 979; *Armendariz, supra*, 24 Cal.4th 83, 91-92, 114-115, 99 Cal.Rptr.2d 745, 6 P.3d 669; see also *Discover Bank, supra*, 36 Cal.4th 148, 154, 30 Cal. Rptr.3d 76, 113 P.3d 1100 [customers of credit card company could reject arbitration term of cardholder agreement only by ceasing to use their accounts].) On the contrary, Circuit City provided Gentry, and other employees, with an extensive orientation about the program, then allowed them a reasonable time to "opt out," without penalty, simply by mailing back a form.

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employment. Applying principles of procedural unconscionability under Massachusetts law, the court deemed essential to its holding that the employees had no meaningful choice whether to accept the provision. (*Id.* at pp. 179-180.)

The instant Court of Appeal determined on this basis that no procedural unconscionability was present. Two Ninth Circuit decisions, applying California law, had previously reached the same conclusion. (*Circuit City Stores, Inc. v. Najd* (9th Cir.2002) 294 F.3d 1104, 1108; *Circuit City Stores, Inc. v. Ahmed* (9th Cir.2002) 283 F.3d 1198, 1199-1200.)

The majority concedes that Gentry's freedom to choose against the arbitration program "weigh[s] against a finding of procedural unconscionability. [Citation.]" (Maj. opn., *ante*, 64 Cal.Rptr.3d at p. 794, 165 P.3d at p. 573.) Nonetheless, the majority discerns an "element" of procedural oppression—thus allowing scrutiny of the agreement's substantive terms—by finding that Circuit City's explanatory materials were "one-sided." (*Ibid.*) In particular, the majority asserts, the explanatory materials failed to disclose that certain terms of the arbitration program might work to an employee's disadvantage in specific situations. Whatever the merits of that premise,[7] the receipt Gentry signed prominently advised that he could *consult his own attorney* about the legal "pros and cons" of the program, and he was given ample opportunity to do so. Under these circumstances, there is no basis for a conclusion that the process by which Circuit City sought to secure its employees' agreement to the program was misleading.

The majority also points out that Circuit City made clear its preference for arbitration. But even if Circuit City encouraged employees to accept the arbitra-

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[7] As the majority makes clear, the informational packet Gentry received included not only the "Associate Issue Resolution Handbook," which sought to explain the program, but also the "Circuit City Dispute Resolution Rules and Procedures," which set forth the program's terms in full.

tion agreement, the record is devoid of any evidence that it implied, threatened, or imposed any sanction for an employee's decision to opt out of the program. I see in this situation no grounds for a finding that Circuit City unfairly coerced or induced its employees' agreement.

Accordingly, I would affirm the judgment of the Court of Appeal.

WE CONCUR: CHIN, and CORRIGAN, JJ.

APPENDIX B

COURT OF APPEAL SECOND DISTRICT,
DIVISION 5, CALIFORNIA

No. B169805

ROBERT GENTRY,
Petitioner,

v.

THE SUPERIOR COURT OF LOS ANGELES COUNTY,
Respondent.

CIRCUIT CITY STORES, INC.,
Real Party in Interest.

Jan. 19, 2006
Rehearing Denied Feb. 9, 2006
Review Granted April 26, 2006

ARMSTRONG, J.

This employment case concerns the enforceability of a pre-employment arbitration agreement containing a class action waiver. The Supreme Court has remanded the case for reconsideration in light of *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148, 30 Cal.Rptr.3d 76, 113 P.3d 1100, in which that Court invalidated a class action waiver in what the Court referred to as a "consumer contract of adhesion" contained in a credit card mailer. We issued an order to show cause and invited supplemental briefing limited to the issue of whether the holding in

Discover Bank invalidates a class action waiver in an employment case of this type. We hold that *Discover Bank* does not render the class action waiver in this case unenforceable. Accordingly, we deny the petition.

FACTS AND PROCEDURAL HISTORY

On August 29, 2002, Robert Gentry filed a class action lawsuit in superior court against Circuit City seeking damages for conversion as well as violations of the Labor Code and Business and Professions Code. Gentry alleged that Circuit City had "illegally misclassified" Gentry and other salaried customer service managers as "exempt managerial/executive employees" not entitled to overtime pay, when in fact, they were "'non-exempt' non-managerial employees" entitled to be compensated for hours worked in excess of 8 hours per day and 40 hours per week[.]

During the time he was employed by Circuit City in 1995, Gentry received a packet that included an "Associate Issue Resolution Package" (AIRP) and a copy of Circuit City's "Dispute Resolution Rules and Procedures," pursuant to which employees are afforded various options (including arbitration) for resolving employment-related disputes. By electing arbitration, the employee agrees to "dismiss any civil action brought by him in contravention of the terms of the parties' agreement." The agreement to arbitrate also contains a class action waiver, which provides: "The Arbitrator shall not consolidate claims of different Associates into one proceeding, nor shall the Arbitrator have the power to hear arbitration as a class action. . . ." The packet includes a form that

gives the employee 30 days to opt out of the arbitration agreement. Gentry did not do so.[1]

At that time, there was a split of authority in California on the enforceability of class action waivers in consumer contracts. In *Szetela v. Discover Bank* (2002) 97 Cal.App.4th 1094, 118 Cal.Rptr.2d 862, the court held that an arbitration provision in a credit card agreement that prohibited class actions was unfair and unconscionable, and thus unenforceable. In *Discover Bank v. Superior Court* (2003) 105 Cal.App.4th 326, 129 Cal.Rptr.2d 393, the Court disagreed with *Szetela* and held that where there is a valid arbitration clause, governed by the Federal Arbitration Act (FAA), the trial court could not apply state substantive law to strike a class action waiver from the arbitration agreement.

The petition to compel arbitration was heard February 26, 2003. Respondent court took the matter under submission and, on February 28, 2003, issued an order granting the petition. The court acknowledged that the governing case law was "conflicting and in a state of flux," and elected to follow *Discover Bank*. The court did hold two provisions of the agreement (cost splitting and limitation of remedies provisions) substantively unconscionable based on federal case law. (*Morrison v. Circuit City Stores, Inc.* (6th Cir.2003) 317 F.3d 646.) The court severed those provisions from the agreement, ordered Gentry to "arbitrate his claims on an individual basis and

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[1] The arbitration agreement contains a choice-of-law provision which provides that the arbitrator "shall apply the substantive law of the State in which the Associate is, was or sought to be predominately employed." Because Gentry was employed in California, we evaluate the enforceability of the agreement under California substantive law.

submit to the class action waiver," and stayed the superior court action.

On April 16, 2003, Gentry appealed the order on the theory that it was a final order regarding class certification. In fact, the order was one compelling arbitration and staying the superior court action, which is not appealable. (Code Civ. Proc., § 1294.) On July 11, 2003, we dismissed the appeal but noted that Gentry had an alternative remedy by way of a petition for writ of mandate.

Gentry filed this mandate petition on September 9, 2003. We initially denied the petition, noting that the issue of the enforceability of the class action waiver was before the Supreme Court. The Supreme Court granted Gentry's petition for review. On June 27, 2005, the court issued its decision in *Discover Bank*. Analyzing the case under general principles of unconscionability, the Court held that "at least under some circumstances, the law in California is that class action waivers in consumer contracts of adhesion are unenforceable, . . ." (*Discover Bank, supra*, 36 Cal.4th at p. 153, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) The Court remanded this employment case for reconsideration in light of *Discover Bank*.

DISCUSSION

The issue in this case is a narrow one: whether the class action waiver in the Circuit City arbitration agreement is an unconscionable provision that renders the provision unenforceable. We conclude the provision is neither procedurally nor substantively unconscionable.

In *Discover Bank*, the Supreme Court analyzed the bank's class action waiver under principles of unconscionability applicable to contracts of adhesion. The

term "contract of adhesion" "signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." (*Graham v. Scissor-Tail, Inc.* (1981) 28 Cal.3d 807, 817, 171 Cal.Rptr. 604, 623 P.2d 165, citing *Neal v. State Farm Ins. Cos.* (1961) 188 Cal.App.2d 690, 694, 10 Cal.Rptr. 781.) "A contract of adhesion is fully enforceable according to its terms [citations] unless certain other factors are present which, under established legal rules—legislative or judicial—operate to render it otherwise." (*Graham v. Scissor-Tail, Inc., supra*, 28 Cal.3d at pp. 819-820, 171 Cal.Rptr. 604, 623 P.2d 165.) "Generally speaking, there are two judicially imposed limitations on the enforcement of adhesion contracts or provisions thereof. The first is that such a contract or provision which does not fall within the reasonable expectations of the weaker or 'adhering' party will not be enforced against him. [Citations.] The second—a principle of equity applicable to all contracts generally—is that a contract or provision, even if consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or 'unconscionable.' [Citations.]" (*Id.* at p. 820, 171 Cal.Rptr. 604, 623 P.2d 165.)

The judicially created doctrine of "unconscionability" contains both procedural and substantive elements. "The procedural element of an unconscionable contract generally takes the form of a contract of adhesion, 'which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.'. . . Substantively unconscionable terms may take various forms, but may generally

be described as unfairly one-sided." (*Little v. Auto Stiegler, Inc.* (2003) 29 Cal.4th 1064, 1071, 130 Cal.Rptr.2d 892, 63 P.3d 979.)

In the employment context, our Supreme Court has found pre-employment arbitration agreements to be adhesive where the agreement is made a condition of employment. (*Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, 115-116, 99 Cal.Rptr.2d 745, 6 P.3d 669; *Little, supra*, 29 Cal.4th at p. 1071, 130 Cal.Rptr.2d 892, 63 P.3d 979.) However, the agreement at issue here does not have that adhesive element and therefore is not procedurally unconscionable. Signing the arbitration agreement was not made a condition of Gentry's employment; he was given 30 days to decide whether or not to opt out of the agreement, and chose not to do so.

The Ninth Circuit has twice held that because of the "opt-out" provision, the 1995 version of the Circuit City arbitration agreement was not procedurally unconscionable. (*Circuit City Stores v. Najd* (9th Cir.2002) 294 F.3d 1104; *Circuit City Stores v. Ahmed* (9th Cir.2002) 283 F.3d 1198, 1200.) In *Ahmed,* the Court noted that the agreement lacked the "necessary element of procedural unconscionability. Ahmed was not presented with a contract of adhesion because he was given the opportunity to opt-out of the Circuit City arbitration program by mailing in a simple one-page form. Moreover, and apart from its non-adhesive nature, the arbitration agreement here also lacked any other indicia of procedural unconscionability. The terms of the arbitration agreement were clearly spelled out in written materials and a videotape presentation; Ahmed was encouraged to contact Circuit City representatives or

to consult an attorney prior to deciding whether to participate in the program; and he was given 30 days to decide whether to participate in the program." (*Id.* at p. 1199.)[2]

Gentry nonetheless claims the agreement is procedurally unconscionable despite the opt-out provision because Circuit City attempted to "sucker unsophisticated employees into not opting out" by touting the advantages of arbitration. His claim is without merit. The "Associate Issue Resolution Handbook," written in straightforward language, does point out the advantages of electing arbitration (notably, that the procedure is cost effective and the employee's claim is resolved "in a matter of weeks or a few months rather than years"). However, it also notes the disadvantages (for example, the lack of a right to a jury trial and limited discovery). The employee is then free to decide whether or not the advantages of arbitration outweigh the disadvantages.

We further find that the class action waiver in this case is not substantively unconscionable. In *Discover Bank*, the Supreme Court found that the class action waiver in the bank's cardholder agreement was both procedurally and substantively unconscionable for a variety of reasons. The amendment was mailed to the cardholder in a "bill stuffer" that the average

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[2] *Ingle v. Circuit City Stores, Inc.* (2003) 328 F.3d 1165, 1175-1176, also decided by the Ninth Circuit, is factually distinguishable. In *Ingle*, the court found an arbitration agreement that included a class action waiver to be procedurally unconscionable because the employee had only three days in which to decide whether or not to opt out of the arbitration agreement. The court held the three-day waiting period did not provide the plaintiff with a "meaningful opportunity" to opt out of the agreement. (*Id.* at p. 1172.)

cardholder was unlikely to read. The cardholder had no opportunity to opt out of the amendment, other than to close his account. (*Discover Bank, supra*, 36 Cal.4th at p. 161, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) These factors provided the element of procedural unconscionability. (*Ibid.*)

The court also found the class action waiver substantively unconscionable because it was "found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages," and it was "alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money. . . ." In such a case, "the waiver becomes in practice the exemption of the party 'from responsibility for [its] own fraud, or willful injury to the person or property of another.' (Civ.Code, § 1668.) Under these circumstances, such waivers are unconscionable under California law and should not be enforced." (*Id.* at pp. 162-163, 30 Cal.Rptr.3d 76, 113 P.3d 1100.)

The infirmities that plagued the *Discover Bank* class action waiver are not present here. The Circuit City agreement is not a "consumer contract of adhesion" that the cardholder had no opportunity to reject. Nor is this a case in which the "disputes between the contracting parties predictably involve small amounts of damages," or where "the party with the superior bargaining power has carried out a scheme to deliberately cheat large number of consumers out of individually small sums of money." (*Discover Bank, supra*, 36 Cal.4th at pp. 162-163, 30 Cal.Rptr.3d 76, 113 P.3d 1100.) The Supreme Court held in *Discover Bank* that under such circum-

stances, enforcing a class action waiver "becomes in practice the exemption of the party 'from responsibility for [its] own fraud, or willful injury to the person or property of another.' (Civ.Code, § 1668.)" (*Ibid.*) Here, Gentry has alleged statutory violations that could result in substantial damages and penalties should he prevail on his individual claims. In fact, the Supreme Court acknowledged in *Discover Bank* that in some employment cases, large individual awards are commonplace. (*Discover Bank, supra*, 36 Cal.4th at p. 168, 30 Cal.Rptr.3d 76, 113 P.3d 1100, see *Gilmer v. Interstate/Johnson Lane Corp.* (1991) 500 U.S. 20, 32, 111 S.Ct. 1647, 114 L.Ed.2d 26.)

DISPOSITION

The petition for writ of mandate is denied. Costs of this proceeding are awarded to Circuit City.

We concur: TURNER, P.J., and KRIEGLER, J.

APPENDIX C

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION FIVE

[Filed Nov. 30, 2005]

B169805
(Super. Ct. No. BC280631)

ROBERT GENTRY,
Petitioner,

v.

THE SUPERIOR COURT OF
LOS ANGELES COUNTY,
Respondent.

CIRCUIT CITY STORES, INC.,
Real Party in Interest.

ORDER TO SHOW CAUSE

TO THE SUPERIOR COURT OF LOS ANGELES COUNTY:

Pursuant to the August 31, 2005 order of the California Supreme Court, a copy of which is attached hereto, you are hereby ordered to show cause before this court in its courtroom at 300 South Spring Street, Los Angeles, California 90013, on January 10, 2006, at 10 a.m., why a peremptory writ ordering you to do so should not issue.

The return to the petition, if any, shall be filed on or before December 9, 2005, and the reply, if any, shall be filed within 10 days thereafter. The parties may incorporate their supplemental briefs in the return and the reply. The sole issue to be decided is whether *Discover Bank v. Superior Court* (2005) 36 Cal.3d 148, 162, invalidates a class action waiver in an employment case of this type.

Nothing in this order to show cause shall be construed to stay any arbitration proceeding.

WITNESS THE HONORABLE PAUL TURNER, Presiding Justice of Division Five of the Court of Appeal of the State of California, Second Appellate District.

ATTEST my hand and the seal of this court this 30th day of November, 2005.

JOSEPH A. LANE, Clerk

By [Illegible]
Deputy Clerk

APPENDIX D

IN THE SUPREME COURT OF CALIFORNIA
En Banc

[Filed Aug. 31, 2005]

No. B1698905
S119334

ROBERT GENTRY,
Petitioner,

v.

THE SUPERIOR COURT OF
LOS ANGELES COUNTY,
Respondent.

CIRCUIT CITY STORES, INC.,
Real Party in Interest.

The above-entitled matter is transferred to the Court of Appeal, Second Appellate District, Division Five, with directions to vacate its decision and to reconsider the cause in light of *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148. (Cal. Rules of Court, rule 29.3(d).)

George
Chief Justice
Kennard
Associate Justice
Baxter
Associate Justice
Werdegar
Associate Justice
Chin
Associate Justice
Moreno
Associate Justice

Associate Justice

APPENDIX E

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION FIVE

[Filed Sept. 18, 2003]

B169805
(Super. Ct. No. BC280631)

ROBERT GENTRY,
Petitioner,

v.

THE SUPERIOR COURT OF
LOS ANGELES COUNTY,
Respondent.

CIRCUIT CITY STORES, INC.,
Real Party in Interest.

ORDER

THE COURT:

The court has read and considered the petition for writ of mandate, filed September 9, 2003. The petition is denied. The court notes that the issue of the validity of the arbitration agreement's class action waiver provision is pending before the California Supreme Court.

TURNER, P.J. GRIGNON, J.

APPENDIX F

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION FIVE

[Filed Sep. 09, 2003]

B169805
(Super. Ct. No. BC280631)

ROBERT GENTRY,
Petitioner,

v.

THE SUPERIOR COURT OF
LOS ANGELES COUNTY,
Respondent.

CIRCUIT CITY STORES, INC.,
Real Party in Interest.

ORDER

Petitioner's stay request is denied. Petitioner has failed to make a showing of urgency or any time constraints that warrant an immediate stay.

/s/ Turner
Paul Turner
Presiding Justice

APPENDIX G

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION FIVE

[Filed JUL 11, 2003]

B166778

(Los Angeles County
Super. Ct. No. BC280631)

ROBERT GENTRY *et al.*,
Plaintiffs and Appellants,

v.

CIRCUIT CITY STORES, INC.,
Defendant and Respondent.

DISMISSAL ORDER

Plaintiff, Robert Gentry, appeals after the trial court entered an order compelling him to arbitrate a dispute with defendant, Circuit City Stores, Inc. The notice of appeal states, "NOTICE IS HEREBY GIVEN that Plaintiffs on their own behalf and on behalf of all putative class members, hereby appeal from the Order of this Court granting Defendant's Petition to Compel Arbitration, filed on February 28, 2003, the Hon. Thomas Wilhite presiding." Defendant has moved to dismiss plaintiff's appeal because an order compelling arbitration and staying an action is not appealable. The parties agree that an order compelling arbitration and staying an action is not appealable. (Code Civ. Proc., § 1294;

Muao v. Grosvenor Properties, Ltd. (2002) 99 Cal.App.4th 1085, 1088.) Further, any issue concerning the class action waiver is not a final appealable order at present. (Code Civ. Proc., § 904.1.)

However, plaintiff argues that the trial court has entered a final order on the issue of class certification which is appealable. (*Griset v. Fair Political Practices Com.* (2001) 25 Cal.4th 688, 698; *Exxon Mobil Corp. v. County of Santa Barbara* (2001) 92 Cal.App.4th 1347, 1351.) No such order was issued. The trial court merely ordered arbitration of plaintiffs individual claims, waiver of the class action claim, and stayed the action. No *final* judicial order has been issued on the class certification issue. Once the stay is lifted, the class certification issues can be finally resolved. The court after the arbitration may choose to elect a number of options including trying the class issues. All that has occurred is that the arbitration of plaintiffs individual claim will proceed.

Three further points are pertinent. First, if plaintiff is dissatisfied with the trial court's orders, he can file an extraordinary relief petition. Plaintiff has a remedy which is readily available to challenge the interlocutory orders of the trial court. Appeal is not such a remedy at present. Second, after the stay is vacated and a final order concerning class certification is entered, then all of the class's contentions may, depending on the circumstances, be reviewable of direct appeal. Third, defendant's sanctions motion is denied. There is no evidence of any conduct which could give rise to monetary sanctions on plaintiffs part. (*In re Marriage of Flaherty* (1982) 31 Cal.3d 637, 650; *Reed v. Mutual*

Service Corp. (2003) 106 Cal.App.4th 1359, 1373, fn. 13.)

The appeal is dismissed. Defendant, Circuit City Stores, Inc., shall recover its costs on appeal from plaintiff, Robert Gentry.

Turner
TURNER, P.J.

Grignon
GRIGNON, J.

APPENDIX H

SUPERIOR COURT OF CALIFORNIA
COUNTY OF LOS ANGELES

[Filed 00-7-03]

DEPT. 23

HONORABLE THOMAS L. WILLHITE, JR. Judge
G YOUNG, CRT ASST. Deputy Sheriff

E T ESPINOZA, Deputy Clerk

BC280631

ROBERT GENTRY,

vs.

CIRCUIT CITY STORES, INC.

-"NOT COMPLEX"-12/4/02
170.6/JUDGE FREEMAN/PLFF

NATURE OF PROCEEDINGS:

NUNC PRO TUNC

The court finds that through inadvertence and error the minute order of February 28, 2003 does not fully reflect the order of the court, said minute order is ordered corrected nunc pro tune as follows:

By adding:

"The matter is stayed pending the outcome of the arbitration."

Counsel are hereby notified that the court has set a status conference for September 11, 2003, 8:30 A.M., this department.

A true copy of this minute order is sent to counsel via U.S. Mail this date as follows:

Matthew Righetti
456 Montgomery Street, Suite 1400
San Francisco, CA 94104

Rex D. Berry
Livingston & Mattesich
1201 K Street, Suite 1100
Sacramento, CA 95814-3938

APPENDIX I

SUPERIOR COURT OF CALIFORNIA
COUNTY OF LOS ANGELES

[Filed 02-28-03]

DEPT. 23

HONORABLE THOMAS L. WILLHITE, JR. Judge
G YOUNG, CRT ASST. Deputy Sheriff

E T ESPINOZA, Deputy Clerk

BC280631

ROBERT GENTRY,

vs.

CIRCUIT CITY STORES, INC.

-"NOT COMPLEX"-12/4/02
170.6/JUDGE FREEMAN/PLFF

NATURE OF PROCEEDINGS:

RULING ON SUBMITTED MATTER

The court having taken PETITION TO COMPEL ARBITRATION under submission on February 26, 2003, now rules as follows:

The court grants the Petition. The court orders plaintiff to arbitrate his claims on an individual basis and submit to the class action waiver. However, the cost splitting and limitation of remedies provisions of the arbitration agreement are unenforceable.

The ruling is more fully set forth in the Court Ruling on Submitted Matter which is filed this date and incorporated herein by reference.

A true copy of this minute order and Court Ruling is sent to counsel via U.S. Mail this date as follows:

Matthew Righetti
456 Montgomery Street, Suite 1400
San Francisco, CA 94104

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1201 K Street, Suite 1100
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APPENDIX J

SUPERIOR COURT OF THE
STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

[Filed FEB 28, 2003]

CASE NUMBER
BC280631

ROBERT GENTRY,
Plaintiff,

vs.

CIRCUIT CITY STORES, INC.,
Defendants.

RULING ON SUBMITTED MATTER

The court having taken PETITION TO COMPEL ARBITRATION under submission on February 26, 2603, now rules as follows:

Plaintiff Robert Gentry filed a class action complaint against defendant Circuit City Stores, Inc. alleging violations of the Labor Code, Business and Professions Code section 17200, and conversion. Plaintiff signed an arbitration agreement with Circuit City in connection with his employment in which he agreed to submit all employment related claims to arbitration. The arbitration procedure also provided: "The Arbitator shall not consolidate claims of different Associates into one proceeding, nor shall the Arbitrator have the power to hear an arbitration as a class action. . . ." (Miles Decl. Exh. B p. 19.) Circuit City petitions to compel plaintiff to arbitrate his claims as an individual. The court grants the

petition. The court orders plaintiff to arbitrate his claims on an individual basis and submit to the class action waiver. However, the cost splitting and limitation of remedies provisions of the arbitration agreement are unenforceable.

As the parties note in their briefing, the governing case law is conflicting and in a state of flux. Circuit City relies primarily on *Discover Bank v. Superior Court* (2003) 105 Cal.App.4th 326[1] and *Morrison v. Circuit City Stores, Inc.* (6th Cir. 2003) __ F.3d __ [2003 WL 193410]. Plaintiff relies on *Szetela v. Discover Bank* (2002) 97 Cal.App.4th 1094, *Ting v. AT&T* (9th Cir. 2003) __ F.3d __ [2003 DJDAR 1630], and also cites *Morrison, supra*. Also relevant are *Mandel v. Household Bank* (2003) __ Cal.App.4th __ [2003 WL 57282 (4th Dist. 1/7/03)] and *Shea v. Household Bank* (2003) __ Cal.App.4th __ [2003 WL 57281 (4th Dist 1/7/03).]

Without adding any further discussion to the debate, the court elects to follow the decision in *Discover Bank, supra*, decided by the Second Appellate District. (See *McCallum v. McCallum* (1987) 190 Cal.App.3d 308, 315, n.4 ["As a practical matter, a superior court ordinarily will follow an appellate opinion emanating from its own district even though it is not bound to do so"].) In *Discover Bank*, the Court found that where there is a valid arbitration agreement governed by the Federal Arbitration Act ("FAA"), California's public policy regarding class action waivers has been preempted. (105 Cal.App.4th at p. 346.) In *Discover Bank*, the dispute involved the enforceability of a credit card holder agreement. *Discover Bank* expressly disagreed with *Szetela v.*

---

[1] Petition for review pending.

Discover Bank (2002) 97 Cal.App.4th 1094 from the Fourth Appellate District. In the instant case, consistent with *Discover Bank*, the court finds that the FAA preempts California's public policy against class action waivers in arbitration agreements.

Gentry argues that the arbitration agreement is unenforceable because it is procedurally and substantively unconscionable. (See *Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83.) If both are present the agreement is unenforceable. (*Id.* at 114.) In the instant case, the agreement is not unenforceable. It is essentially undisputed that Circuit City drafted the agreement, and had superior bargaining power. However, Gentry was given the option of opting out of the arbitration agreement. Circuit City provided an "Arbitration Opt-Out Form," containing identical instructions for Associates who chose not to participate in the arbitration component of the AIRP. Gentry did not opt out and did not return the form. The agreement is not procedurally unconscionable.

Only two provisions of the agreement are substantively unconscionable, the cost-splitting provision and the limitation of remedies provision. In *Morrison v. Circuit City Stores, Inc., supra*, 2003 WL 193410, the Court held that statutory claims may be heard in an arbitral forum, the Circuit City arbitration agreement was supported by sufficient consideration and a mutuality of obligation and the provisions regarding discovery and the limitations period arc enforceable. (*Id.* at 13, 15 and n. 16.) However, the Court invalidated both the cost-splitting and limitation of remedies provisions in the Circuit City arbitration agreement. (*Id.* at 18-22.) In the instant case, the court ends that the agreement is

not invalid as a whole, and only the cost splitting and limitation of remedies provisions are unenforceable. Therefore, the court orders plaintiff to arbitrate his claims on an individual basis and submit to the class action waiver. However, the cost splitting and limitation of remedies provisions of the arbitration agreement are unenforceable.

APPENDIX K

IN THE SUPREME COURT OF CALIFORNIA
En Banc

[Filed Oct. 31, 2007]

S141502

Court of Appeal,
Second Appellate District,
Div. 5 - B169805

ROBERT GENTRY,
Petitioner,

v.

SUPERIOR COURT OF LOS ANGELES COUNTY,
Respondent;

CIRCUIT CITY STORES, INC.,
Real Party in Interest.

The petition for rehearing is denied.

Baxter, Chin and Corrigan, JJ., are of the opinion the petition should be granted.

George

Chief Justice

APPENDIX L

STATE STATUTE

Cal. Labor Code § 1194. Action to recover minimum wage, overtime compensation, interest, attorney's fees, and costs by employee

(a) Notwithstanding any agreement to work for a lesser wage, any employee receiving less than the legal minimum wage or the legal overtime compensation applicable to the employee is entitled to recover in a civil action the unpaid balance of the full amount of this minimum wage or overtime compensation, including interest thereon, reasonable attorney's fees, and costs of suit.

(b) The amendments made to this section by Chapter 825 of the Statutes of 1991 shall apply only to civil actions commenced on or after January 1, 1992.

87

No. 07-998

FILED
FEB 29 2008
OFFICE OF THE CLERK
SUPREME COURT, U.S.

In The

Supreme Court of the United States

CIRCUIT CITY STORES, INC.,

Petitioner,

v.

ROBERT GENTRY,

Respondent.

On Petition For Writ Of Certiorari To The Supreme Court Of California

BRIEF IN OPPOSITION

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INTRODUCTION

Circuit City's petition for writ of certiorari does not comply with the requirement of Supreme Court Rule 14(1)(g) that a petitioner must state "when the federal questions sought to be reviewed were raised, the method or manner of raising them, and the way in which they were passed on by those courts." Circuit City *cannot* comply with this rule because it did not raise either of its Questions Presented in the California courts. Neither should be considered by this Court.

Section 2 of the Federal Arbitration Act ("FAA"), which is its preemption provision, states that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Circuit City argued below that a state law rule invalidating its contractual class arbitration ban would be preempted by the FAA because such a rule would discriminate against *arbitration clauses only.* Indeed in the California Supreme Court, Circuit City's preemption argument was much narrower; it asserted that if the Supreme Court held that class action bans in wage and hour cases were always or presumptively invalid, such a bright-line rule would be preempted. The California high court rejected any across-the-board rule, opting instead for a case-by-case approach in which a given plaintiff must prove that a particular class action ban is exculpatory under the facts of the specific case.

In this Court, Circuit City now asserts new and significantly different preemption claims that the California courts never had an opportunity to address. In its first Question Presented, Circuit City focuses on the last two words in FAA § 2 – "any contract" – and contends that the decision below violates the FAA because its rationale is based on state labor policies that do not apply generally to "any contract." In its second Question Presented, Circuit City argues that the California Supreme Court's procedural unconscionability analysis improperly discriminates against arbitration because it imposes a unique requirement that arbitration agreements must expressly compare the relative "disadvantages" of arbitration to the "advantages" of litigation.

Circuit City's failure to raise these issues below, where they could have been thoroughly litigated, is compounded by its strategy in this Court of mischaracterizing the reasoning of the decision below in an effort to create conflicts with decisions of the federal circuit courts and this Court. In reality, such conflicts do not exist, further undercutting any claim for a grant of review.

The first Question Presented is based on a handful of federal circuit decisions involving state statutes or cases that affect only contracts in a single industry. Because of the narrowness of the state laws, the circuit courts held that they did not apply to "any contract" and were thus preempted by the FAA. However, the California Supreme Court's analysis

applies to *all* contracts that effectively bar individuals from vindicating rights under remedial statutes, thus causing a waiver of unwaivable rights. The governing principle is codified in California Civil Code § 1668, which provides, "*All contracts* which have for their object, directly or indirectly to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." Ital. added. *See* Pet. App. 7a-8a. Circuit City's characterization of this generally applicable principle of California contract law as being limited to "state labor law policies" is plainly inaccurate.

In its second Question Presented, Circuit City claims that the California Supreme Court's ruling on procedural unconscionability conflicts with this Court's decisions on arbitration neutrality by requiring an arbitration-specific notice concerning the disadvantages of arbitration as compared to litigation. Once again, Circuit City has seriously misread the decision below. The California Court did not impose a notice requirement solely on arbitration agreements. Rather it held that procedural unconscionability was implicated *in this case* because Circuit City deceived its employees into not opting out of arbitration by touting the theoretical benefits of arbitration while concealing the many ways in which its particular arbitration rules actually strip employees of important statutory rights. Many California decisions apply the same reasoning to

non-arbitration contracts that deprive individuals of such rights.

Finally, Circuit City's contention that the decision below conflicts with a Third Circuit case, *Gay v. CreditInform*, ___ F.3d ___, 2007 WL 4410362 (3d Cir. Dec. 19, 2007), also provides no basis for a grant of review. In *Gay*, the Third Circuit dealt with unique Pennsylvania law that "obvious[ly]" applied unconscionability differently to arbitration agreements than to non-arbitration agreements. *Id.* at *21. That is not true of the decision below. California courts have struck as unconscionable class action bans that were contained in contracts that did not involve arbitration.

This Petition for Certiorari should also be rejected for lack of a final judgment under 28 U.S.C. § 1257(a). The California Supreme Court did not deny Circuit City's petition to compel arbitration. Instead, it remanded to the trial court for fact-finding as to whether petitioner's class arbitration ban is actually exculpatory. Pet. App. 29a, 41a. Thus there has been no final determination of any federal question. By asking this Court to review the case at this stage, petitioner not only seeks to avoid the jurisdictional "final judgment" requirement but also implicitly asserts that *it does not matter what the facts are* because federal law *requires* that Circuit City be allowed to misuse arbitration to deprive individuals

of substantive statutory rights. This Court should reject petitioner's unsupported and extreme position.

STATEMENT OF THE CASE

A. Gentry's Class Action Suit and Circuit City's Arbitration Agreement

Robert Gentry was employed as a customer service manager for Circuit City Stores, Inc. In August 2002, he filed a class action against Circuit City. The suit alleged that Circuit City was violating California statutes and wage orders by failing to pay overtime compensation to its customer service managers, who were wrongfully classified as "exempt" employees. Cal. S. Ct. Exhibits in Support of Petition for Writ of Mandate and/or Prohibition ("Cal. Exhs.") 1-15. In support of the class action remedy, the complaint alleged that the claims of the individual class members were not sufficiently large to warrant vigorous prosecution and that if each employee were required to file an individual lawsuit, Circuit City would gain an unconscionable advantage because of its vastly superior resources. *Id.* 9. The complaint also alleged that, without class actions, many employees would not pursue their rights because of their "real and justifiable fear of retaliation." *Ibid.*

Circuit City petitioned to compel arbitration of Gentry's individual claims and to dismiss the lawsuit. It alleged that Gentry had entered into an agreement

in which he agreed to submit all employment-related claims to arbitration. *Id.* 16-71. Circuit City did not claim that Gentry had actually signed an arbitration agreement. Instead, it argued that in March 1995 Gentry had failed to send in a form that would have allowed him to opt out of its arbitration program and thus he was bound to the agreement by his inaction. *Id.* 31-38.

The arbitration materials that Circuit City gave to Gentry and other employees in March 1995 strongly encouraged them *not* to opt out and concealed that Circuit City's 1995 arbitration rules drastically limited substantive rights guaranteed by California law. The Circuit City handbook proclaimed: "WHY ARBITRATION IS RIGHT FOR YOU AND CIRCUIT CITY" and set forth general statements about the benefits of arbitration. Cal. Exhs. 46. The handbook did *not* inform employees that Circuit City's arbitration program stripped workers of the following legal rights. Pet. App. 37a.

- Circuit City's arbitration rules restricted employees to one year of back pay from the point the employee knew or should have known of the legal violation. Cal. Exhs. 59. Under California law, an employee can recover back pay for a three-year or four-year period from the date the cause of action accrued. Cal. Code Civ. Proc. § 338; Cal. Bus. & Prof. Code § 17208; *Cortez v. Purolator Air Filtration Products Co.*, 23 Cal.4th 163, 168, 178-179 (2000).

- Circuit City's arbitration rules imposed a one-year statute of limitation on all claims. Cal. Exhs. 59. California law provides a three-year statute of limitations for recovering overtime wages (Cal. Code Civ. Proc. § 338) and a four-year statute for an unfair competition claim. Bus. & Prof. Code § 17208.

- Circuit City's arbitration rules placed the burden of proof on the employee in all instances. Cal. Exhs. 56. Under California law (as under the Fair Labor Standards Act, 29 U.S.C. § 201 *et seq.*), the employer has the burden to prove that an employee is exempt and thus ineligible for overtime pay. *Ramirez v. Yosemite Water Co.*, 20 Cal.4th 785, 794-795 (1999); *Corning Glass Works v. Brennan*, 417 U.S. 188, 196-197 (1974).

- Circuit City's arbitration rules provided that parties will "generally" be liable for their own attorney fees, with the arbitrator having "discretion" to award fees to a prevailing employee. Cal. Exhs. 59. Under California law, a prevailing employee in an overtime case is "entitled" to recover reasonable attorney fees and costs. Cal. Lab. Code § 1194(a).

- Circuit City's arbitration rules prohibited all class actions and even the consolidation of different employees' claims. Cal. Exhs. 57. California law permits

> consolidation of claims and class actions where appropriate.[1]

Over Gentry's objections, the trial court granted Circuit City's petition to compel arbitration and ordered Gentry to arbitrate his claims individually. Pet. App. 75a. Gentry's petition for writ of mandate to the California Court of Appeal was summarily denied. *Id.* 68a. The California Supreme Court granted review and deferred action pending its decision in *Discover Bank v. Superior Court*, a consumer case involving a form arbitration agreement prohibiting class actions. After its decision in *Discover Bank*, 36 Cal.4th 148 (2005), the California Supreme Court in August 2005 remanded this case to the Court of Appeal with directions "to vacate its decision and to reconsider the cause in light of *Discover Bank*." Pet. App. 4a, 67a. On remand, the Court of Appeal ruled that Circuit City's class action prohibition was not substantively unconscionable under *Discover Bank* and was not procedurally unconscionable because of the opt-out provision. *Id.* 5a, 56a-66a. The California Supreme Court again granted review.

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[1] Circuit City's arbitration rules imposed other one-sided or highly restrictive provisions. Employees were required to arbitrate but the company was free to go to court. Cal. Exhs. 52. Circuit City had the unilateral right to modify the arbitration rules every year. *Id.* 60. Front pay was available only in "rare" cases, for a maximum of 24 months, and punitive damages were limited to $5000. *Id.* 59.

B. The California Supreme Court's Decision

1. The Class Arbitration Ban

The California Supreme Court reversed and remanded for further proceedings. The Court reasoned as follows. Gentry's lawsuit was filed pursuant to California Labor Code § 1194, which provides an unwaivable private right of action to enforce violations of California's overtime laws. Employees' rights to timely payment of overtime are rooted in the important public policy of protecting the health and welfare of the workers themselves as well as the general health and welfare. Pet. App. 11a. Even though a party may be compelled to arbitrate such statutory rights and thus to "submit[ ] to their resolution in an arbitral, rather than a judicial, forum," the arbitration rules cannot be used to accomplish a de facto, exculpatory waiver of these rights. *Little v. Auto Stiegler, Inc.*, 29 Cal.4th 1064 (2003), quoting *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991); Pet. App. 12a.

"Under *some* circumstances," the Court reasoned, a class arbitration ban would cause a de facto waiver of statutory rights and would impermissibly interfere with employees' ability to enforce the overtime laws, just as such waivers in some consumer cases are unconscionable and unenforceable where they make it unduly difficult for affected consumers to pursue legal remedies. *See Discover Bank v. Superior Court*, *supra*, 36 Cal.4th 148; Pet. App. 13a, ital. added. Class action prohibitions in wage and hour cases may

have such an exculpatory effect under California law for several reasons.

First, awards in wage cases tend to be modest, making it less likely that many employees will bring individual actions. *Id.* 13a-14a. Second, a current employee will hesitate to bring an individual action against his or her employer because of the risk of retaliation. *Id.* 17a-19a, citing *Mitchell v. Robert DeMario Jewelry, Inc.*, 361 U.S. 288, 292 (1960) ("[I]t needs no argument to show that fear of economic retaliation might often operate to induce aggrieved employees quietly to accept substandard conditions."). Third, some individual employees will not pursue their legal rights because they are unaware the rights have been violated, especially where, as alleged here, the employer affirmatively tells its employees they are not eligible for overtime. *Id.* 20a. These problems may be reduced by class actions, in which workers band together to assert their rights. *Id.* 21a-23a.

The Court emphasized that not all class arbitration prohibitions in overtime cases are unenforceable and that a trial court must evaluate their exculpatory impact on a case-by-case basis, determining on the facts of each case whether the ban interferes with enforcement of unwaivable statutory rights. Pet. App. 22a-23a. The Court remanded the case to enable the trial court to decide the validity of Circuit City's class ban under these guidelines. The Court noted that if the ban were invalidated, the parties would proceed to class arbitration (if the class was certified), unless they stipulated to have the matter heard in court or

unless the entire arbitration agreement was held unconscionable because of its other allegedly unconscionable terms, which Gentry timely challenged but the California Supreme Court did not reach. *Id.* 29a. Thus, under the Court's decision, invalidating a class arbitration ban leaves the parties in an arbitration forum, not in court. *Id.* 25a.

2. FAA Preemption

The California Court rejected Circuit City's argument that a rule invalidating class arbitration bans discriminates against arbitration clauses in violation of the FAA. The Court reasoned that the principle that a class action ban may be invalid where it interferes with the enforcement of unwaivable statutory rights is an "arbitration-neutral rule: it applies to class waivers in arbitration and nonarbitration provisions alike." Pet. App. 27a. Such a principle is an "application[ ] of general state law contract principles regarding the unwaivability of public rights to the unique context of arbitration, and accordingly [is] not preempted by the FAA." *Ibid.*, quoting *Little, supra,* 29 Cal.4th at 1079.

At no stage of the proceedings below did Circuit City argue that an agreement to arbitrate cannot be invalidated by state-law policies other than those that apply to "any contract." 9 U.S.C. § 2.

3. Procedural Unconscionability

The California Supreme Court reached the issue of procedural unconscionability in connection with Gentry's challenge to the validity of provisions in the Circuit City arbitration agreement *other than* the class arbitration ban. The Court rejected the lower courts' determination that there was no procedural unconscionability, which rested on Gentry's supposed right to opt out of arbitration in March 1995. The Court found that the evidence demonstrated, under longstanding California unconscionability standards, that Gentry's failure to opt out of arbitration did not represent an "authentic informed choice." Pet. App. 36a.

First, the explanation of arbitration in the Circuit City handbook was "markedly one-sided." *Ibid.* By emphasizing that arbitration was "much less expensive" and that the "arbitrator can award money damages to compensate you" without mentioning the many significant disadvantages that Circuit City had inserted into *this particular arbitration agreement* (*supra*, pp. 6-8), the handbook presented a "highly distorted picture of the arbitration Circuit City was offering." Pet. App. 38a. The legally unsophisticated employees who would be the likely plaintiffs in suits seeking overtime pay would not have understood that these rules and procedures are considerably less favorable to an employee than the rules normally available in a judicial forum. *Id.* 38a-39a.

Second, Circuit City employees would have felt pressure *not* to opt out of arbitration because the

explanatory materials Circuit City provided – including the all-caps heading "WHY ARBITRATION IS RIGHT FOR YOU AND CIRCUIT CITY" – made unmistakably clear that Circuit City strongly preferred arbitration and wanted its employees *not* to opt out. *Id.* 39a.[2]

These factors led the Court to conclude that "some degree of procedural unconscionability" was present, sufficient to potentially require judicial scrutiny of substantive unconscionability by the trial court on remand. *Id.* 40a. Under California unconscionability analysis, a sliding scale is invoked; the more substantively unconscionable contract terms are, the less evidence of procedural unconscionability is required to conclude that they are unenforceable, and vice versa. *Id.* 34a.

At no stage of the proceedings below did Circuit City argue that a finding of procedural unconscionability based on the misleading representations in petitioner's handbook would be preempted as constituting an arbitration-specific requirement that arbitration agreements must compare the relative "disadvantages" of arbitration with the "advantages" of litigation.

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[2] Although the Circuit City handbook said that employees could consult with an attorney about their legal rights, the Court found it "unrealistic" to expect anyone other than higher echelon employees to hire an attorney to review what appears to be a routine personnel document. Pet. App. 39a.

REASONS FOR DENYING THE WRIT

I. THE COURT LACKS JURISDICTION OVER THIS CASE BECAUSE THE DECISION BELOW, REMANDING FOR FURTHER PROCEEDINGS TO DETERMINE THE FEDERAL QUESTION, IS NOT A FINAL JUDGMENT UNDER 28 U.S.C. § 1257(a).

This Court has jurisdiction to review "[f]inal judgments or decrees rendered by the highest court of a State in which a decision could be had. . . . " 28 U.S.C. § 1257(a). Section 1257(a) establishes a "firm final judgment rule" in which the state court's decision is "final as an effective determination of the litigation and not of merely interlocutory or intermediate steps therein." *Jefferson v. City of Tarrant, Ala.*, 522 U.S. 75, 81 (1957). Section 1257's requirement of finality "is not one of those technicalities to be easily scorned. It is an important factor in the smooth working of our federal system." *Id.*, quoting *Radio Station WOW, Inc. v. Johnson,* 326 U.S. 120, 124 (1945). The principal exceptions to the final judgment rule apply where the federal question has been finally decided but there will be further proceedings in the lower state courts. *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975).

Here, this Court lacks jurisdiction under § 1257(a) since the California Supreme Court did not issue a final judgment or decree and did not finally determine any federal question. Instead, the Court set forth general principles, to be applied on a case-by-case basis depending on the evidence presented,

and remanded to allow for further determinations by the trial court on numerous issues, subject to further appellate review.

On remand, the trial court must make factual findings about whether, *on the facts of this case,* Circuit City's class arbitration ban is invalid because it significantly interferes with the vindication of unwaivable statutory rights of its employees. If the trial court answers yes to this question, the parties may proceed to arbitrate over the appropriateness of class certification in this case – *unless* (1) they agree to have the case heard in court after all, or (2) the trial court invalidates the arbitration agreement altogether because of its many *other* oppressive, one-sided provisions. Pet. App. 29a, 41a. In short, there has not yet been a final determination of the federal question and there are so many contingencies to be exhausted and issues to be decided that the decision of the California Supreme Court is not a final judgment under § 1257(a).

Circuit City contends that this Court has jurisdiction based on *Southland Corp. v. Keating*, 465 U.S. 1 (1984) and *Perry v. Thomas*, 482 U.S. 483 (1987). Pet. 1. Neither case controls because in both, the lower courts had rendered final decisions on the federal questions at issue. In *Southland*, the California Supreme Court had ruled that the California Franchise Investment Law guaranteed a judicial (not arbitral) forum for claims under that statute and that this requirement was not preempted by the FAA. This Court held it had jurisdiction because the California

Supreme Court had finally determined the federal issue as to these parties. *Southland Corp, supra*, 465 U.S. at 6-8. In *Perry v. Thomas,* the California courts, rejecting a claim of FAA preemption, had refused to compel arbitration of an action for wages in reliance on a California statute that guaranteed a judicial forum for wage suits. Citing *Southland*, this Court held, without discussion, that it had jurisdiction. *Perry, supra,* 482 U.S. at 489 n. 7.

Because in this matter there has been no decision of the federal question as to these parties, this case presents no basis to depart from § 1257(a)'s imposition of a "firm final judgment rule." The Court lacks jurisdiction, and the Petition must therefore be denied.

II. THIS IS NOT AN APPROPRIATE CASE FOR DECIDING THE FIRST QUESTION PRESENTED BECAUSE THAT ISSUE WAS NEVER RAISED BELOW AND NO CONFLICT EXISTS.

In its first Question Presented, Circuit City asserts that the California Supreme Court decision conflicts with several federal circuits on the question whether state-law policies other than those that apply to "any contract" may preclude enforcement of the terms of an agreement to arbitrate. 9 U.S.C. § 2; Pet. 15. This issue is not worthy of review because it was not presented below and because there is no split of authority.

A. Circuit City's First Question Presented Was Not Raised Below.

Circuit City did not present its current "any contract" argument to the California courts. To the extent it argued FAA preemption below, Circuit City contended that a rule invalidating class arbitration waivers discriminates against *arbitration clauses* in violation of the FAA. Pet. App. 26a-27a; Circuit City Brief in Cal. Supreme Court, pp. 46-52. Accordingly, the California courts did not have the opportunity to address Circuit City's new "any contract" argument.

This Court "will not consider a petitioner's federal claim unless it was either addressed by, or properly presented to, the state court that rendered the decision" under review. *Adams v. Robertson*, 520 U.S. 83, 86 (1997). In *Adams*, the Court refused to consider issues raised in the state court for the first time on a petition for rehearing. Here, where the argument was *never* raised in the state courts, there is even less reason to make it the basis for a grant of review.

B. The "Any Contract" Argument Does Not Present a Basis for Review in Any Event Because the Allegedly Conflicting Decisions Are Distinguishable.

On the merits as well, Circuit City's first question does not warrant review because the cases it cites for the alleged conflict are all distinguishable.

The principal case on which Circuit City relies is *Bradley v. Harris Research, Inc.*, 275 F.3d 884 (9th

Cir. 2001). In *Bradley*, a California statute imposed specific venue requirements on all franchise agreements (including franchise arbitration agreements) that involved businesses operating within California. The Ninth Circuit held that, because the statute applied *only* to franchise agreements – *not to contracts generally* – and had the effect of invalidating some provisions of arbitration agreements, it violated the FAA § 2.

The *Bradley* court carefully distinguished the case before it from cases in which the party opposing arbitration raised generally applicable contract defenses, such as unconscionability. *Id.* at 889-890 and n. 7, citing *Ticknor v. Choice Hotels Intern., Inc.*, 265 F.3d 931 (9th Cir. 2001). In the latter type of case, the Ninth Circuit recognized this Court's often-quoted statement in *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996) that "generally applicable contract defenses, such as fraud, duress or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." *Id.* at 687.

The four other cases cited by Circuit City are similarly distinguishable. Three involve state statutes governing contracts in a single industry (franchise, construction and beer). *KKW Enterprises, Inc. v. Gloria Jean's Gourmet Coffees Franchising Corp.*, 184 F.3d 42 (1st Cir. 1999); *OPE International LP v. Chet Morrison Contractors, Inc.*, 258 F.3d 443 (5th Cir. 2001); *Stawski Distributing Co. v. Browary Zywiec S.A.*, 349 F.3d 1023 (7th Cir. 2003). The fourth involves state case law applicable only to franchise

contracts. *Doctor's Associates, Inc. v. Hamilton*, 150 F.3d 157 (2d Cir. 1998) In each case, the court held that state law was preempted because it was limited to one type of contract.

By contrast, this case involves a "generally applicable contract defense" under California law – namely, that contract terms are invalid if they prevent individuals from effectively vindicating unwaivable statutory rights and are effectively exculpatory. *Little v. Auto Stiegler, Inc.*, *supra*, 29 Cal.4th at 1079. That defense is *not* limited to "state labor law policy," as Circuit City contends, but applies to any exculpatory contract contrary to public policy. Pet. App. 27a. This principle is codified in California Civil Code § 1668, which expressly indicates its universal application: "*All contracts* which have for their object, directly or indirectly to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." Ital. added, *see* Pet. App. 7a-8a.

Civil Code § 1668 and the defense it codifies have been applied to many types of contracts. *E.g.*, *Discover Bank, supra*, 36 Cal.4th 148 (class arbitration prohibition in consumer credit card transaction); *Tunkl v. Regents of University of California*, 60 Cal.2d 92, 99-100 (1962) (release from liability for future negligence imposed as condition for patient's admission to charity hospital); *Gavin W. v. YMCA of Metropolitan Los Angeles*, 106 Cal.App.4th 662, 670-671 (2003) (parental release of liability involving

child-care program); *In re Marriage of Fell*, 55 Cal.App.4th 1058, 1063-1065 (1997) (waiver of disclosure by parties to a dissolution); *Baker Pacific Corp. v. Suttles*, 220 Cal.App.3d 1148, 1153-1154 (1981) (employee waiver of all employer liability for asbestos exposure); *Halliday v. Greene*, 244 Cal.App.2d 482, 488 (1966) (exculpatory waiver of safety order in residential lease).

The principle embodied in § 1668 is consistent with this Court's repeated holdings that "[b]y agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral . . . forum." *Preston v. Ferrer*, ___ U.S. ___, 2008 WL 440670 *8 (U.S. Feb. 20, 2008); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985); *Gilmer, supra*, 500 U.S. at 26.

Thus, review of the first Question Presented should be denied because the issue was not raised below and because the alleged conflict does not exist.

III. THE SECOND QUESTION PRESENTED DOES NOT WARRANT REVIEW BECAUSE IT WAS NOT RAISED BELOW AND IS BASED ON A MISCHARACTERIZATION OF THE DECISION BELOW.

The second Question Presented is also not worthy of review. It was not presented below and it is premised on an erroneous construction of the decision below. Circuit City contends that the California

Supreme Court's analysis of procedural unconscionability created an "arbitration-specific requirement that an individual be specifically provided an explanation of the 'disadvantages' of arbitration as compared to litigation." Pet. 26. That is simply not so.

It is, of course, well established that unconscionability is a generally applicable contract defense that is *not* preempted by the FAA. 9 U.S.C. § 2; *Doctor's Associates, supra*, 517 U.S. at 687. Under California law, procedural unconscionability focuses on oppression or surprise due to unequal bargaining power and, under California's "sliding scale" analysis, the more substantive unconscionability is present, the less procedural unconscionability is required to conclude that a contract term is unenforceable. Pet. App. 34a; *Discover Bank, supra*, 36 Cal.4th at 160. In analyzing procedural unconscionability in this case, the California Supreme Court was responding to Circuit City's argument that because Gentry could have opted out of arbitration, there could be no such unconscionability. The Court concluded that the Circuit City agreement was "at the very least, not entirely free from procedural unconscionability" because there were several indications that Gentry's failure to opt out did not represent "an authentic informed choice." Pet. App. 36a, 39a-40a.

First, the Circuit City handbook's explanation of the benefits of arbitration was "markedly one-sided," which meant that the employees would receive a "highly distorted" picture of the arbitration Circuit City was offering. *Id.* 36a, 38a. The handbook touted

the *generic* benefits of arbitration but concealed the many provisions in Circuit City's *actual* arbitration program that deprived employees of statutory protections provided by California law, including the drastic limitation on damages, the significantly shorter statute of limitations, the reversal of the burden of proof, the general denial of attorneys' fees to a prevailing employee, and the class action ban. *See supra*, pp. 6-8. Additionally, employees likely felt pressure *not* to opt out of arbitration because Circuit City's published materials made it "unmistakably clear" that the company wanted its employees to participate in the arbitration program. Pet. App. 39a.

Circuit City contends that the California Supreme Court's analysis "required an additional arbitration-specific obligation to disclose every possible way in which the rules of arbitration might be deemed 'less favorable to an employee than those operating in a judicial forum.'" Pet. 26. That argument seriously misconstrues the decision below and takes the single-quoted phrase in the previous sentence out of context to make its inaccurate point. *See* Pet. App. 38a. The California court was not imposing a notice requirement only on arbitration agreements. It was simply saying that procedural unconscionability is implicated where a stronger party tricks a weaker party into being contractually bound by concealing the unfavorable terms of an agreement.

California courts regularly apply this principle to all manner of contracts. *See, e.g, Pardee Construction*

Co. v. Superior Court, 100 Cal.App.4th 1081, 1089-1090 (2002) (residential construction contract held unconscionable where oppressive provisions were not explained and were buried in form contract); *Ilkhchooyi v. Best*, 37 Cal.App.4th 395, 410 (1995) (commercial lease provision held unconscionable where profit-shifting clause was buried in small print in long paragraphs under inaccurate heading and lessor assured tenant that lease was the same as earlier one); *Ellis v. McKinnon Broadcasting Co.*, 18 Cal.App.4th 1796, 1804 (1993) (forfeiture provision in employment contract held unconscionable because it was not explained to employee); *A & M Produce Co. v. FMC Corp.*, 135 Cal.App.3d 473, 489-491 (1982) (warranty disclaimer and damage exclusion in commercial contract held unconscionable where not pointed out to weaker party).

Petitioner never raised below its current argument about the alleged preemption of this rule of procedural unconscionability even though Gentry made the procedural unconscionability argument that the California Supreme Court ultimately accepted. Gentry Opening Brief in Cal. Supreme Court, pp. 54-57. If Circuit City had made such a preemption argument, the California Court would have had the opportunity to explain that it applied the same unconscionability analysis in this case that it would have applied in any case involving a "markedly one-sided" and "highly distorted" contract description.

This case is distinguishable from the two cases Circuit City cites in an effort to establish a conflict,

Perry v. Thomas, *supra*, 482 U.S. 483 and *Doctor's Associates, Inc.*, *supra*, 517 U.S. 681. In both cases, state statutes clearly established arbitration-specific rules. In *Perry*, the statute specifically exempted wage collection actions from arbitration and guaranteed a judicial forum for such claims. In *Doctor's Associates,* the statute required contracts subject to arbitration to display a unique notice in underlined capital letters on the first page. The instant case, by contrast, involves no such arbitration-specific rule.

This case is also distinguishable from *Gay v. CreditInform*, *supra*, ___ F.3d ___, 2007 WL 4410362. Circuit City's contention that the two decisions conflict in their unconscionability analyses is incorrect. In *Gay*, the Third Circuit refused to follow Pennsylvania state court decisions that invalidated class arbitration bans as unconscionable because, according to the Third Circuit, "although written ostensibly to apply general principles of contract law," the Pennsylvania decisions "hold that an agreement to arbitrate may be unconscionable simply because it is an agreement to arbitrate." *Id.* at *20. In other words, the *Gay* court refused to follow Pennsylvania unconscionability analysis because it concluded that the Pennsylvania courts were treating arbitration clauses more hostilely than they would have treated similar clauses in non-arbitration agreements. The California Supreme Court's analysis, by contrast, applied the well-established, arbitration-neutral California principle that procedural unconscionability may be implicated where a weaker party is induced to enter into a

markedly unfavorable contract based on surprise or other sharp practices.[3]

The Ninth Circuit in *Lowden v. T-Mobile USA*, ___ F.3d ___, 2008 WL 170279 (9th Cir. Jan. 22, 2008) refused to follow *Gay* because it found that *Gay* dealt with unique Pennsylvania law that was in conflict with the FAA. The Ninth Circuit stated, "Unlike the Third Circuit's conclusion as to the applicable state law in *Gay*, we determine that the Washington Supreme Court in *Scott* does not hold 'that an agreement to arbitrate may be unconscionable simply because it is an agreement to arbitrate.'" *Id.* at *8 n. 3.

In the decision below, as well as many others, the California Supreme Court has shown its deference to the principle that the FAA prohibits the imposition of arbitration-specific requirements. Pet. App. 26a-27a;

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[3] We anticipate that the amici curiae supporting Circuit City may argue that *Gay* conflicts with the decision below for broader reasons – namely, the Third Circuit flatly upheld the validity of a class arbitration ban while the California Supreme Court held such a ban may be unenforceable in some cases. Besides being premature, such an argument would be wrong. *Gay* found class bans valid because the state-law arguments against them were based on hostility to arbitration. By contrast, the California Supreme Court's decision held such bans to a standard that applies both to arbitration and non-arbitration contracts. *See, America Online, Inc. v. Superior Court*, 90 Cal.App.4th 1 (2001) (choice of law provision in non-arbitration contract, which had the effect of banning class actions, held invalid), cited with approval in *Discover Bank v. Superior Court*, *supra*, 36 Cal.4th at 158-159.

Armendariz v. Foundation Health Psychcare Services, 24 Cal.4th 83, 119 (2000) ("[T]he United States Supreme Court has taught 'that a court may not rely upon anything that is unique to an agreement to arbitrate when assessing unconscionability of an agreement governed by the FAA'"); *Little, supra*, 29 Cal.4th at 1080 ("We recognize that '[i]n enacting § 2 of the [FAA], Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration'"); *Discover Bank, supra*, 36 Cal.4th at 167 ("[T]he FAA does not federalize the law of unconscionability or related contract defenses except to the extent that it forbids the use of such defenses to discriminate against arbitration clauses").

The decision below is consistent with these principles and does not warrant review.

CONCLUSION

For the foregoing reasons, the Petition for Certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

CIRCUIT CITY STORES, INC.,

Petitioner,

v.

ROBERT GENTRY,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of California

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REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

In its Petition, Circuit City Stores, Inc. ("Circuit City") showed that the refusal of the California Supreme Court, based on state labor law policies, to enforce the parties' agreement to arbitrate individually conflicts with decisions of five federal circuit courts and the decisions of this Court interpreting Section 2 of the Federal Arbitration Act ("FAA"). Pet. 3, 15-24. Circuit City further showed that the unconscionability ruling by the court below conflicted with this Court's decisions and a decision of the Third Circuit because the California Supreme Court impermissibly applied arbitration-specific standards to conclude that the arbitration agreement was procedurally unconscionable. *Id.* at 4, 24-30.

Since filing its petition, Circuit City's position has been reaffirmed by this Court in *Preston* v. *Ferrer*, 128 S. Ct. 978 (2008). In *Preston*, this Court held that, under the FAA, an agreement to arbitrate could neither be deferred nor avoided based on California's Talent Agency Act because that law impermissibly "imposes prerequisites to enforcement of an arbitration agreement that *are not applicable to contracts generally*." *Id.* at 985 (following *Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996)). The *Preston* Court held that the California law was preempted by Section 2 of the FAA because it "frustrated" and "hinder[ed] speedy resolution of the controversy" in accordance with the parties' agreement to arbitrate. *Id.* at 986. That is what the California Supreme Court has done here: By refusing to enforce the parties' agreement to arbitrate individually and instead remanding for further proceedings that do not apply to "any contract," and

further, by establishing an "arbitration-specific" test for procedural unconscionability, the decision below violates the FAA and thus warrants further review and reversal by this Court.

Respondent's brief in opposition ("Opp.") does not address the holding in *Preston*. Nor can respondent deny that the decision below is vitally important given the multiple *amici* explaining the profound impact that the California Supreme Court's decision would have if left unreviewed by this Court. *See* Brief of *Amicus Curiae* of the Chamber of Commerce of the United States of America at 3 (explaining that decision below throws into "jeopardy" the "validity of millions of contracts reflecting the intent of parties to arbitrate"); Brief of *Amicus Curiae* of Pacific Legal Foundation at 3 ("California's hostility toward arbitration contracts affects many millions of employees and businesses"); Brief of *Amici Curiae* of Ace American Ins. Co. et al. at 3, 5-6 (explaining "widespread implications" of questions presented).

Instead, respondent adopts a scattershot approach, arguing that review should be denied because (i) Circuit City "fail[ed] to raise these issues below," Opp. 2, (ii) there is no "final judgment under 28 U.S.C. § 1257(a)," *id.* at 4, and (iii) there is no conflict on either question because Circuit City has "mischaracteriz[ed] the reasoning of the decision below," *id.* at 2.[1] As shown below, none of these arguments withstands scrutiny.

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[1] Respondent attempts to divert attention from the stark conflicts implicated in this case by arguing that the 1995 version of Circuit City's arbitration rules "drastically limited substantive rights guaranteed by California law." Opp. 6; *id.* at 6-8. That argument – which Circuit City rejects – simply has no bearing on the merits of this petition. Indeed, the court below expressly declined to address Circuit City's showing that later

A. This Court Has Jurisdiction Over The Questions Presented.

1. Respondent's lead argument – *i.e.*, that the "Questions Presented" are not properly before this Court, Opp. 1-2, 11, 13, 17, 23 – is insubstantial.

Respondent contends that "[a]t no stage of the proceedings below did Circuit City argue that an agreement to arbitrate cannot be invalidated by state-law policies other than those that apply to 'any contract.'" *Id.* at 11 (quoting 9 U.S.C. § 2). That is false. In the California Supreme Court, Circuit City argued, point blank:

> Section 2 of the FAA requires state and federal courts to enforce the terms of arbitration contracts, unless they . . . are subject to "such grounds as exist at law or equity for the revocation of any contract." 9 U.S.C. § 2. No "additional limitations under state law" may be applied to invalidate an enforceable arbitration agreement.

Circuit City's Answer Brief ("Answer Brief") at 46 (quoting *Southland Corp.* v. *Keating*, 465 U.S. 1, 10-11 (1984)).

Respondent is likewise wrong in asserting that Circuit City did not advance its unconscionability argument below. Opp. 13, 23. To the contrary, Circuit City relied heavily on *Perry* v. *Thomas*, 482 U.S. 483, 490-91 & n.9 (1987), see Answer Brief at 47-48, and argued, as it does now, that any "arbitration-specific rule would be preempted by the FAA" and that a "contrary rule of 'unconscionability' necessarily

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amendments superseded these challenged provisions. Pet. App. 41a n.11.

would be arbitration-specific, and preempted by the FAA." *Id.* at 50-51.

Further, as a legal matter, "[t]here can be no question as to the proper presentation of a federal claim when the highest state court passes on it." *Raley* v. *Ohio*, 360 U.S. 423, 436-37 (1959); *accord Jenkins* v. *Georgia*, 418 U.S. 153, 157 (1974); Gressman et al., *Supreme Court Practice* 197 (9th ed. 2007) ("Once it is clear that the highest state court has actually passed on the federal question, any inquiry into how or when the question was raised in the state courts is considered irrelevant . . . ."). In its petition, Circuit City highlighted that the California Supreme Court had expressly rejected its position that the FAA foreclosed state-law rules that would deny enforcement of its agreement to arbitrate. Pet. 11 (citing Pet. App. 26a-29a). That decision makes clear that the court below considered and passed on Circuit City's arguments regarding FAA preemption. Pet. App. 26a-27a ("Nor do we accept Circuit City's argument that a rule invalidating class arbitration waivers discriminates against arbitration clauses in violation of the [FAA]."); *id.* at 27a ("We also continue to reject Circuit City's suggestion . . . that compelling class arbitration in the appropriate case violates the FAA.").

2. Equally meritless is respondent's claim that this Court "lacks jurisdiction under § 1257(a)." Opp. 14. The governing rule is that "judgments of state courts that finally decide a federal issue are immediately appealable when [i] 'the party seeking review here might prevail [in the state court] on the merits of nonfederal grounds, . . . [ii] where reversal of the state court on the federal issue would be preclusive of any further litigation on the relevant cause of action' . . . and [iii] 'refusal immediately to

review the state-court decision might seriously erode federal policy.'" *Southland Corp.* v. *Keating*, 465 U.S. 1, 6 (1984) (second alteration in original) (quoting *Cox Broad. Corp.* v. *Cohn*, 420 U.S. 469, 483 (1975)).

Applying that framework to the FAA, this Court in *Southland* held that "to delay review of a state judicial decision denying enforcement of the contract to arbitrate until the state-court litigation has run its course would defeat the core purpose of a contract to arbitrate." *Id.* at 7-8; *accord Perry*, 482 U.S. at 489 n.7. Since then, this Court repeatedly has exercised jurisdiction and reversed state court judgments that denied enforcement or made enforcement of agreements to arbitrate contingent on proceedings that would violate the FAA. See, *e.g.*, *Buckeye Check Cashing, Inc.* v. *Cardegna*, 546 U.S. 440, 449 (2006); *Citizens Bank* v. *Alafabco, Inc.*, 539 U.S. 52, 58 (2003) (per curiam); *Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681, 689 (1996); *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 282 (1995).

Respondent asserts that neither *Southland* nor *Perry* "controls because in both, the lower courts had rendered final decisions on the federal questions at issue." Opp. 15. As discussed above, the California Supreme Court unquestionably rendered a final judgment rejecting Circuit City's showing that the FAA preempted state-law rules "compelling class arbitration in the appropriate case." Pet. App. 27a. This Court thus has jurisdiction under § 1257(a) over the judgment of the court below. See *Southland*, 465 U.S. at 6-7; *Perry*, 482 U.S. at 489 n.7.

Respondent suggests that jurisdiction is divested because the decision below leaves open for remand whether Circuit City might be able to enforce its agreement to arbitrate by satisfying the state-law standards that Circuit City contends violate federal

law. See Opp. 15. That possibility, however, is irrelevant because even if "'the party seeking review here might prevail [in the state court] on the merits of nonfederal grounds,'" jurisdiction in this Court is proper. *Southland*, 465 U.S. at 6 (alteration in original). This Court has rejected respondent's argument for cases involving the FAA because delaying review "until the state-court litigation has run its course would defeat the core purpose of a contract to arbitrate." *Id.* at 7-8. Indeed, just last month, in *Preston*, this Court exercised jurisdiction and reversed a state court judgment that did not strike down an agreement to arbitrate, but instead made enforcement of arbitration contingent on preliminary proceedings that were not "applicable to contracts generally." 128 S. Ct. at 985 (following *Doctor's Assocs.*, 517 U.S. at 687).

This Court plainly has jurisdiction over the petition in this case.

B. This Case Implicates A Deep Conflict On Whether Enforcement Of An Arbitration Agreement May Be Refused Based On State Law That Does Not Apply To "Any Contract."

Respondent attempts to dismiss the conflict implicated by the decision below as involving merely "a handful of federal circuit decisions." Opp. 2. But respondent cannot escape that the California Supreme Court's decision makes enforcement of the parties' agreement to arbitrate contingent on application of California labor law, not on principles applicable to "any contract." 9 U.S.C. § 2. As such, the decision below conflicts directly with rulings by five separate federal courts of appeals which hold that enforcement of agreements under the FAA cannot be denied based on a state law that "does not

apply to 'any contract.'" *Bradley* v. *Harris Research, Inc.*, 275 F.3d 884, 890 (9th Cir. 2001) (quoting 9 U.S.C. § 2); see also Pet. 3 (citing conflicting cases).

Respondent does not dispute that these circuits hold that enforcement of the terms of arbitration agreements cannot be avoided based upon state laws that do not apply to "any contract." 9 U.S.C. § 2. Here, however, the California Supreme Court made enforcement of the parties' arbitration agreement contingent on an assessment whether individual arbitration protected by the FAA was consistent with California labor law principles, which the court below called "unwaivable." Pet. App. 10a (interpreting California Labor Code § 1194); see also *id.* at 1a ("we consider whether class arbitration waivers" violate "statutory rights to overtime pay pursuant to Labor Code section 500 et seq. and 1194"); *id.* at 25a (applying strong public policy behind § 1194). As such, the decision below authorizes California courts to disregard the terms of agreements to arbitrate based on whether a court believes that different procedures would be "significantly more effective" in vindicating class members' right to overtime pay. *Id.* at 23a.

That ruling directly conflicts with circuit decisions from across the country, see Pet. 3, and is also flatly inconsistent with this Court's holdings. For example, in *Southland*, this Court reversed the California Supreme Court's refusal to enforce an agreement to arbitrate based on state law that prohibited any agreement "'to waive compliance with any provision'" of state franchise law. 465 U.S. at 10. This Court held that arbitration must go forward because "the California Franchise Investment Law is not a ground that exists at law or in equity 'for the revocation of *any* contract.'" *Id.* at 16 n.11; see also *Perry*, 482 U.S.

at 490-91 (FAA preempts California state policy that precluded arbitration of labor disputes).

Respondent insists, however, that there is no conflict. He claims that the decision below does not refuse to enforce the arbitration agreement based on State labor law but instead is an application of a "'generally applicable contract defense'" "codified in California Civil Code § 1668, which expressly indicates its *universal application*." Opp. 19 (emphasis added). That is wrong because the California Supreme Court's decision expressly relied upon and applied "the strong public policy behind section 1194" of California Labor Code. See Cal. Labor Code § 1194; Pet. App. 25a. In any event, contrary to respondent's argument, Section 1668 does *not* have "universal application" and is thus not grounds under California law "for the revocation of any contract." 9 U.S.C. § 2. Indeed, the California Supreme Court has held that § 1668 applies only to the subset of contracts that involve the "public interest." *Tunkl* v. *Regents*, 383 P.2d 441 (Cal. 1963).[2]

C. The Unconscionability Ruling Conflicts With Decisions Of This Court And The Third Circuit.

Review also should be granted because the California Supreme Court's unconscionability ruling

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[2] *See also Vilner* v. *Crocker Nat'l Bank* 89 Cal. App. 3d 732, 735 (1979) ("Despite its broad language, section 1668 does not apply to every contract"); *accord Cregg* v. *Ministor Ventures*, 148 Cal. App. 3d 1107, 1111 (1983) ("[Section 1668] will be applied only to contracts that involve 'the public interest.'"); 1 Witkin, *Summary of California Law* § 660, at 737-38 (10th ed. 2005) (Section 1668 does not apply to contracts where "no public interest is involved").

adopts an arbitration-specific rule in violation of this Court's decisions in *Perry* and *Doctor's Associates*, and in conflict with the Third Circuit's decision in *Gay* v. *CreditInform*, 511 F.3d 369 (3d Cir. 2007).

Respondent denies any conflict, arguing that "unconscionability is a generally applicable contract defense that is *not* preempted by the FAA." Opp. 21. That argument ignores *Perry*, in which this Court explained that "[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with . . . § 2," and thus, for example, a court could not "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." 482 U.S. at 493 n.9. Relying on *Perry*, the Third Circuit in *Gay* likewise has ruled that a state unconscionability law is not insulated from review under the FAA when it relies on "the uniqueness" of the arbitration provision as a basis for refusing to enforce the terms of the parties' agreement. 511 F.3d at 395. Indeed, respondent acknowledges that the Ninth Circuit has deepened this conflict by "refus[ing] to follow *Gay*." Opp. 25 (citing *Lowden* v. *T-Mobile USA*, 512 F.3d 1213 (9th Cir. 2008)).

Here, the California Supreme Court did not apply generally applicable contract law or conclude that the parties' agreement was procedurally unconscionable because Circuit City "conceal[ed] the unfavorable terms of an agreement." Opp. 22. To the contrary, the majority acknowledged that (i) the terms of the arbitration agreement were set forth in full in Circuit City's "Dispute Resolution Rules and Procedures," Pet. App. 38a, (ii) respondent was given 30 days to review and consider those terms, *id.* at 33a, (iii) respondent was advised that he could "'consult with

an attorney'" about his legal rights, *id.* at 39a, and (iv) respondent expressly acknowledged that his decision whether to participate in the arbitration program was "'voluntary,'" *id.* at 32a. Respondent ignores these undisputed facts in suggesting that the decision below merely employed unconscionability principles that "regularly apply . . . to all manner of contracts." Opp. 22.[3]

What mattered to the court below was that even though Circuit City acknowledged "some of the shortcomings of arbitration in a general sense, it did not mention any of the additional significant disadvantages that *this particular arbitration agreement* had compared to litigation." Pet. App. 37a. That, however, is an impermissible arbitration-specific standard in violation of this Court's ruling that "[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with . . . § 2." *Perry*, 482 U.S. at 493 n.9; *accord Doctor's Assocs.*, 517 U.S. at 685. As such, respondent cannot distinguish *Perry*,

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[3] *Cf. Pardee Constr. Co.* v. *Superior Court*, 100 Cal. App. 4th 1081, 1089-90 (2002) (operative paragraph "was difficult to read and misleading" and agreement "omitted mention of the economically significant matter of referee's fees"); *Ilkhchooyi* v. *Best*, 37 Cal. App. 4th 395, 410 (1995) (party affirmatively misled by assurances that term in new lease was "basically the same" as an earlier lease when in fact a new provision had been added in diminutive print in the middle of one of five lengthy paragraphs); *Ellis* v. *McKinnon Broad. Co.*, 18 Cal. App. 4th 1796, 1804 (1993) (party asked to sign form "without warning" and affirmatively told that it was a "'formality'"); *A & M Produce Co.* v. *FMC Corp.*, 135 Cal. App. 3d 473, 489-91 (1982) (provisions procedurally unconscionable when party presented evidence that he was surprised by terms that were "only casually shown to [him]").

Doctor's Associates, or the Third Circuit's ruling in *Gay*.

Lastly, respondent suggests that "employees likely felt pressure *not* to opt out of arbitration" because Circuit City's materials made clear it preferred arbitration. Opp. 22. Under California law, however, the party opposing enforcement of a contract has the affirmative burden of proving unconscionability. *E.g.*, *Brutoco Eng'g & Constr., Inc.* v. *Superior Court*, 107 Cal. App. 4th 1326, 1331 (2003). Here, respondent "signed an easily readable, one-page form that accompanied receipt of the Associate Issue Resolution Package," which explained the procedures if he wanted to *opt out* of arbitration with Circuit City and confirmed that respondent was aware that the program was "'voluntary.'" Pet. App. 32a-33a. Speculation that respondent nevertheless might have "felt pressure" cannot defeat arbitration under the FAA because "[m]ere inequality in bargaining power . . . is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context." *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 33 (1991).

CONCLUSION

For the foregoing reasons, and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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In The
Supreme Court of the United States

CIRCUIT CITY STORES, INC.,

Petitioner,

vs.

ROBERT GENTRY,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of California

BRIEF OF *AMICI CURIAE* ACE AMERICAN INSURANCE COMPANY; BALLY TOTAL FITNESS CORPORATION; RALPHS GROCERY COMPANY; RENT-A-CENTER, INC. AND 24 HOUR FITNESS USA, INC. IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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STATEMENT OF INTEREST OF *AMICI CURIAE*[1]

This brief of *amici curiae* in support of Petitioner Circuit City Stores, Inc. is submitted by ACE American Insurance Company; Bally Total Fitness Corporation; Ralphs Grocery Company; Rent-A-Center, Inc. and 24 Hour Fitness USA, Inc. pursuant to Rule 37 of this Court. *Amici* urge that the Court grant the requested petition for writ of certiorari and reverse the judgment of the Supreme Court of California.

ACE American Insurance Company provides insurance and reinsurance for a diverse group of corporate and consumer clients. ACE American Insurance Company currently has approximately 2,500 employees throughout the United States, including substantial numbers in California.

Bally Total Fitness Corporation is a leading provider of fitness services, operating approximately 350 fitness clubs nationwide. Bally Total Fitness Corporation has more than 20,000 employees in approximately 30 states, including substantial numbers in California.

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[1] Counsel of record received timely notice of the intent to file this brief under Rule 37.2(a). Letters from all parties consenting to the filing of this brief have been filed with the Clerk of this Court. No counsel for a party authored this brief in whole or in part, and no person or entity other than *amici curiae*, or their counsel, made a monetary contribution to the preparation or submission of this brief.

Ralphs Grocery Company runs more than 400 supermarkets under the Ralphs, Food 4 Less, and Foods Co. banners, mostly in California but also in Illinois, Indiana, and Nevada. The company also runs warehouse-style stores under the Food 4 Less and Foods Co. banners. Ralphs Grocery Company has approximately 35,000 employees, including substantial numbers in California.

Rent-A-Center, Inc. is a nationwide rent-to-own chain. Its stores offer name-brand furniture, electronics, appliances and computers through flexible rental purchase agreements that generally allow the customer to obtain ownership of the merchandise at the conclusion of an agreed upon rental period. It owns and operates more than 3,400 stores in North America and Puerto Rico under the Rent-A-Center, Rent-Way, Rent Rite, Rainbow Rentals, and Get It Now names and franchises almost 300 through subsidiary ColorTyme. It has over 21,000 employees, including substantial numbers in California, and operates in all of the United States.

24 Hour Fitness USA, Inc. is a privately owned and operated leading fitness center chain. It owns and operates more than 350 fitness centers that offer aerobic, cardiovascular, and weight lifting activities to more than 3 million members. 24 Hour Fitness USA, Inc. employs nearly 20,000 employees in 14 states, including substantial numbers in California.

Amici are employers who require or request that their applicants and employees enter into arbitration

agreements that contain in one form or another class action waiver clauses such as that which is at issue in the instant case. Together, the *amici* employ almost 100,000 individuals across the United States, including substantial numbers in California. Accordingly, *amici* have a direct and substantial interest in the outcome of the instant case.

SUMMARY OF ARGUMENT

The enforceability of employment arbitration agreements as written is of paramount importance to employers and should be addressed by the U.S. Supreme Court.

The enforceability of employment arbitration agreements is an issue of rising significance. Studies undertaken in the last 15 years show a dramatic rise in the use of employment arbitration agreements. *Amici* are just a few of the large number of employers in the United States that have a significant interest in the outcome of the instant case.

Despite the increasing importance of employment arbitration agreements, since 2000, the California Supreme Court has imposed ever-deepening layers of requirements and limitations on such agreements. The first layer of requirements was imposed by *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83 (2000) ("*Armendariz*") with respect to actions brought under the California Fair Employment and Housing Act ("FEHA"). *Little v.*

Auto Stiegler, Inc., 29 Cal. 4th 1067 (2003), *cert. denied*, 540 U.S. 818 (2003) ("*Little*") extended the *Armendariz* requirements to the California tort of wrongful termination in violation of public policy. Then, in *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005) ("*Discover Bank*"), the California Supreme Court imposed another set of restrictions upon *consumer* arbitration agreements that contain class action waiver clauses. Most recently, in *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007) ("*Gentry*"), the California Supreme Court added yet another set of requirements for *employment* arbitration agreements that contain class action waiver clauses. The California Supreme Court's requirements and restrictions upon employment arbitration agreements conflict with the preemption principles of Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* and the opinions of this Court.

The California Supreme Court's divergence from the FAA and opinions of this Court must be checked. *Gentry* directly contradicts federal authority and also adds to a lack of uniformity among the states. Accordingly, the Court should grant the writ of certiorari.

ARGUMENT

I. THE ENFORCEABILITY OF EMPLOYMENT ARBITRATION AGREEMENTS IS A SIGNIFICANT ISSUE FOR NATIONWIDE EMPLOYERS.

The enforceability of employment arbitration agreements as written is of increasing importance to employers that conduct business in California and the other states.

Since the U.S. Supreme Court's landmark decision in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) ("*Gilmer*"), the use of employment arbitration has risen steadily. Although there is no public standard data set indicating the percentage of organizations that have adopted employment arbitration procedures, a series of studies show the upward trajectory of the use of such procedures among U.S. employers. Alexander J.S. Colvin, *Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury?* 11 Employee Rights and Employment Policy Journal 2 (2007).

As reported by Professor Colvin, a 1992 survey indicated that approximately *2 percent of employers* had adopted employment arbitration agreements for nonunion employees. *Id.*; *see also* Peter Feuille & Denise R. Chachere, *Looking Fair and Being Fair: Remedial Voice Procedures in Nonunion Workplaces,* 21 J. Mgmt. 27 (1995). A 1995 survey by the General Accounting Office (GAO) found that approximately *9.9 percent of employers* surveyed had adopted employment

arbitration procedures for nonunion employees. General Accounting Office, GAO/HEHS 95-150, Employment Discrimination, Most Private Sector Employers Use Alternative Disputes Resolution 7-8 (1995), available at www.gao.gov/archive/1995/he95150.pdf. In a 2003 survey of employers in the telecommunications industry, *22.7 percent of non-union employees* were covered by employment arbitration procedures.

Because large employers are more likely to have relatively sophisticated human resources management practices, such as more elaborate employment dispute resolution procedures, the proportion of employees subject to employment arbitration agreements likely is higher than the proportion of employers subject to employment arbitration agreements.

Accordingly, the issues presented in the instant case have significant, widespread implications for *amici* as well as nationwide employers and should be addressed forthwith.

II. THE CALIFORNIA SUPREME COURT HAS IMPOSED EVER-BURGEONING AND IMPERMISSIBLE CONDITIONS TO THE ENFORCEABILITY OF EMPLOYMENT ARBITRATION AGREEMENTS.

Culminating in *Gentry*, in recent years, the California Supreme Court has imposed a series of requirements for employment arbitration agreements that conflict with principles of FAA preemption and the opinions of this Court. The divergence not only

conflicts with federal authority, but also creates a lack of uniformity among the states. Employers doing business in California, therefore, face unique obstacles to the enforcement of their arbitration agreements.

A. The FAA Preempts State Law Restricting The Enforcement Of Arbitration Agreements That Does Not Apply To Contracts Generally.

Arbitration agreements governed by the FAA must be enforced under the same rules that apply to any contract. Specifically, the FAA provides:

> A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract*.

9 U.S.C. § 2 (emphasis added).

The FAA was enacted to overcome courts' reluctance to enforce arbitration agreements. 9 U.S.C. § 1 *et seq.*; *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 121-122 (2001); *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 89-90 (2000) (the Supreme Court "rejected

generalized attacks on arbitration that rest on 'suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be-complainants'"); *Allied-Bruce Terminix Cos. v. Dobson,* 513 U.S. 265, 270 (1995); *Perry v. Thomas,* 482 U.S. 483, 490-491 (1987) (the FAA "embodies Congress' intent to provide for the enforcement of arbitration agreements within the full reach of the Commerce clause . . . the preeminent concern of Congress . . . was to enforce private agreements"); *id.* at 492 n.9 ("state law . . . is applicable *if* that law arose to govern issues concerning . . . contracts generally"); *Southland Corp. v. Keating,* 465 U.S. 1, 10 (1984) (in enacting the FAA, "Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration"); *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983) (the FAA evidences Congress' intent "to move the parties to an arbitrable dispute and into arbitration as quickly and easily as possible") ("*Moses H. Cone*").

The creation of a defense specifically applicable to arbitration agreements violates the FAA. *Doctor's Assocs., Inc. v. Casarotto,* 517 U.S. 681, 687-688 (1996) (the FAA preempts state legislation that would restrict the enforcement of arbitration agreements) ("*Casarotto*"); *see also Preston v. Ferrer,* ___ U.S. ___, 128 S. Ct. 978 (2008); *Buckeye Check Cashing, Inc. v. Cardegna,* 546 U.S. 440, 442-443 (2006) ("*Buckeye*

Check Cashing"); *Volt Info. Sciences v. Leland Stanford Jr. Univ.*, 489 U.S. 468, 478, 474 (1989) (arbitration agreements are enforced "in accordance with their terms," although enforcement is limited by general contract principles "at law or in equity for the revocation of any contract"); *Southland Corp. v. Keating*, 465 U.S. 1, 10-11, 16 n.11 (1984) (Congress "intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements" based on state laws that do not provide a basis for the revocation of any contract); *Moses H. Cone* at 24-25 (section 2 of the FAA reflects "a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary").

This preemption rule applies even where a state's public policies would otherwise prevent enforcement. For example, in *Buckeye Check Cashing*, the United States Supreme Court reversed a Florida Supreme Court ruling that required certain otherwise arbitral issues to be litigated in court. The Court held that a state's public policy cannot dictate the forum for the resolution of disputes when an arbitration agreement governed by the FAA requires that the forum be that which was chosen by the parties to the agreement. *Id.* at 446 ("we cannot accept the . . . conclusion that enforceability of the arbitration agreement should turn on [state] public policy and contract law" (internal quotations omitted)); *accord*, *Preston v. Ferrer*, 128 S. Ct. 978; *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 55, 58 (1995) (FAA

precludes judicially created rules hostile to enforcement of arbitration agreements notwithstanding their bases in a state's public policy).

In *Gilmer*, the Court recognized that statutory claims, even where the statutes were intended to further important social policies, are arbitrable, unless Congress evinced an intention to preclude waiver of judicial remedies. 500 U.S. at 26-27. This Court also expressly rejected the argument that arbitration procedures cannot adequately further statutory purposes merely because they do not provide for class actions. *Id.* ("if the arbitration could not go forward as a class action or class relief could not be granted by the arbitrator, the fact that the . . . ADEA . . . provides for the possibility of bringing a collective action does not mean that individual attempts at conciliation were intended to be barred").

B. The California Supreme Court's Rulings Overstep FAA Principles.

In approximately 2000, the California Supreme Court signaled its departure from FAA principles, opinions of this Court, and authority in other jurisdictions. The departure has culminated in *Gentry*.

1. *Armendariz v. Foundation Health Psychcare Services, Inc.*

In *Armendariz*, the California Supreme Court held that claims brought under the California Fair Employment and Housing Act (FEHA), Cal. Gov't

Code § 12900, are arbitrable "*if* the arbitration permits an employee to vindicate his or her statutory rights." *Armendariz* at 91 (emphasis in the original).

The California Supreme Court recognized that the FAA generally preempts state legislation that would restrict the enforcement of arbitration agreements. *Casarotto* at 687-688. However, despite that recognition, the California Supreme Court imposed four affirmative obligations for enforcement of mandatory pre-dispute arbitration agreements otherwise applicable to FEHA claims: neutrality of the arbitrator, adequate discovery, a written decision that will permit judicial review, and apportionment of costs of arbitration on the employer solely. *Id.* at 103-113.

In doing so, the California court focused on language of *Mitsubishi Motors v. Soler Chrysler-Plymouth*, 473 U.S. 614, 628 (1985), which states, "[b]y agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum"). The California court also focused on *Gilmer* at 33-34, suggesting that "*Gilmer,* both explicitly and implicitly, placed limits on the arbitration of such rights. . . . *Gilmer* cannot be read as holding that an arbitration agreement is enforceable no matter what rights it waives or what burdens it imposes." *Armendariz* at 101. The California Supreme Court thus reasoned that "an arbitration agreement cannot be made to serve as a vehicle for the waiver of statutory rights created by the FEHA." *Id.* at 101.

The problem with this approach was that the unwaivable "statutory rights" described in *Armendariz* were nowhere to be found in the text of the FEHA. The California Supreme Court, however, offered two provisions of California contract law that ostensibly permit the invalidation of a contract on public policy grounds: California Civil Code section 1668 ("all contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law") and California Civil Code section 3513 ("[a]nyone may waive the advantage of a law intended solely for his benefit. But a law established for public reason cannot be contravened by private agreement"). *Id.* at 100-101. The court reasoned that the public, as well as individuals, have an interest in FEHA cases. *Id.* at 100 (describing the public policy against unlawful discrimination). The California Supreme Court analyzed objections to the arbitration agreement for unconscionability, a defense applicable to any contract; however, the California Supreme Court's four minimum factors were not based on unconscionability analysis. *Id.* at 113-127.

2. *Little v. Auto Stiegler, Inc.*

The California Supreme Court expanded *Armendariz's* reach in *Little*, which held that in order for a common law tort cause of action for wrongful termination in violation of public policy to be arbitrable,

the employment arbitration agreement must adhere to the four minimum standards set forth in *Armendariz*.

The California Supreme Court followed the reasoning of *Armendariz*, explaining that the four minimum standards "were founded on the premise that certain statutory rights are unwaivable" and that "because an employer cannot ask the employee to waive [a claim for wrongful termination in violation of public policy], it also cannot impose on the arbitration of these claims such burdens or procedural shortcomings as to preclude their vindication." *Little* at 1076. The Court rejected FAA preemption on the ground that "although the *Armendariz* requirements specifically concern arbitration agreements, they do not do so out of a generalized mistrust of arbitration per se." *Little* at 1079, *quoting Casarotto* at 687.

3. *Discover Bank v. Superior Court.*

In *Discover Bank*, the California Supreme Court set limits on the enforceability of consumer arbitration agreements that contained clauses waiving the right of the parties to bring class claims. The Court concluded that "at least under some circumstances, the law in California is that class action waivers in consumer contracts of adhesion are unenforceable. . . ." *Discover Bank* at 153. The Court explained, "because . . . damages in a consumer case are often small . . . the class action is often the only effective way to halt

and redress exploitation." *Id.* Thus, in effect, where disputes between contracting parties:

> predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then . . . such waivers are unconscionable under California law and should not be enforced.

Id. at 162-163. This rule applied even if any individual could fully vindicate his or her personal right to recovery by invoking the arbitral forum.

Discover Bank, like *Armendariz* and *Little*, relied on California Civil Code section 1668 ("all contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law"). However, this time, the California Supreme Court based its opinion on unconscionability as well as public policy grounds. *Discover Bank* at 161 ("class action waivers found in such contracts may also be substantively unconscionable inasmuch as they may operate effectively as exculpatory contract clauses that are contrary to public policy").

The Court explained *Gilmer* by observing that "the ADEA is an employment discrimination statute in which large individual awards are commonplace." *Id.* at 168. *Gilmer*, however, is not premised on this

supposed distinction. Moreover, the California court recognized its divergence from opinions in other jurisdictions: "We acknowledge that other courts disagree. Some courts have viewed class actions or arbitrations as a merely procedural right, the waiver of which is not unconscionable." *Id.* at 161 (citations omitted).

4. *Gentry v. Superior Court.*

This line of California authority culminates in *Gentry*, an employment class action based on alleged violation of state wage and hour laws. The California court held that, "at least in some cases, the prohibition of classwide relief would undermine the vindication of the employees' unwaivable statutory rights and would pose a serious obstacle to the enforcement of the state's overtime laws." *Gentry* at 559. *Gentry* is even further afield from FAA and U.S. Supreme Court authority than *Armendariz, Little*, and *Discover Bank*, and it sets up unique barriers to contract enforcement that find no counterpart anywhere else.

In reaching its conclusion, the California court stated that "we had no occasion in *Discover Bank* to consider whether a class action or class arbitration waiver would undermine the plaintiff's statutory rights." *Id.* at 562. The *Gentry* court, citing *Armendariz,* however, retreated from contractual unconscionability analysis and relied instead upon the conclusion that minimum wage and overtime requirements under the California Labor Code are nonwaivable. *Gentry* at 451 ("a finding of procedural

unconscionability is not required to invalidate a class arbitration waiver if that waiver implicates unwaivable statutory rights . . . [b]ut such a finding is a prerequisite to determining that the arbitration agreement as a whole is unconscionable"); *id.* at 467 (" . . . the validity of class arbitration waiver was analyzed in the previous part of this opinion in terms of unwaivable statutory rights rather than unconscionability").

The California Supreme Court closely followed *Bell v. Farmers Ins. Exchange,* 115 Cal. App. 4th 715, 746 (2004) ("*Bell*"), which addresses California class certification standards but does not involve enforcement of an arbitration contract or, indeed, *any* contract. The *Gentry* court expressed concern that in the absence of the availability of class relief, class members may be left with (citing *Bell*) "no more than the prospect of 'random and fragmentary enforcement' of the employer's legal obligation to pay overtime." *Gentry* at 462. The Court reasoned that the availability of class actions "eliminates the possibility of repetitious litigation" and warned of the "inefficiency" of separate, non-class proceedings. *Id.* at 459.

The California Supreme Court tasked the trial courts, when determining whether to enforce a class action waiver clause in an employment arbitration agreement, with consideration of four factors, three of which were added for the first time to an already complex equation: (1) the modest size of the potential individual recovery (first announced in *Discover Bank*), (2) the potential for retaliation against members of

the class, (3) the fact that absent class members may be ill-informed of their rights, and (4) "other real world obstacles to the vindication of class members' rights to overtime pay through individual arbitration." *Gentry* at 463.

Following *Gentry*, California employers and employees have little or no control over whether an arbitral class action waiver clause will be enforced. Indeed, inasmuch as the *Gentry* factors find their genesis in California's public policy supporting certain class actions, contract law analysis is but an afterthought. Because the enforceability of an employment arbitral class action waiver clause now depends on these new and not well defined factors, rather than the language of the arbitration agreement, the outcome of a *Gentry* analysis is impossible to predict and certain to engender one court battle after another, rather than "mov[ing] the parties to an arbitrable dispute . . . into arbitration as quickly and easily as possible." *Moses H. Cone* at 24-25.

This lack of predictability, in fact, *undermines* California contract law because "predictability of the consequences of actions related to employment contracts is important to commercial stability." *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 696 (1988).[2]

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[2] The *Foley* Court rejected arguments that a "special relationship" akin to insurer/insured existed in the employment context. 47 Cal. 3d at 693. *Foley*, instead, found "no sound reason to exempt the employment relationship from the ordinary rules of

(Continued on following page)

III. *GENTRY* CONFLICTS WITH FEDERAL LAW ON NUMEROUS GROUNDS.

A. *Gentry* Does Not Find Support In Congressional Policy.

Gentry imposes limitations on arbitration agreements that do not apply to contracts generally. Its reliance on *Bell* and retreat from contract law unconscionability analysis demonstrates its departure from accepted FAA principles. Public policy bases for the certification of certain class actions have nothing to do with contract law and therefore are not a ground that exists in law or equity for the revocation of any contract. 9 U.S.C. § 2.

Congress has not elevated the availability of state court class actions above the enforcement of arbitration agreements governed by the FAA. To the contrary, in 2005 Congress expressed deep suspicion of such class actions in the Class Action Fairness Act ("CAFA"). In its statement of Findings and Purpose, Congress described "abuses of the class action device" that have "harmed class members" as well as defendants, "adversely affected interstate commerce" and "undermined public respect for our judicial system." Congress found, "Class members often receive little or

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contract interpretation. . . ." *Id.* at 681. *Perry v. Thomas*, 482 U.S. at 492 n.9, forbids courts from construing an arbitration "agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law."

no benefit from class actions, and are sometimes harmed," citing large counsel fees, inadequate awards to the class or excessive awards to certain class members, and confusing class notices. It particularly expressed concern with class action "[a]buses" in the "State and local courts." See 28 U.S.C. § 1711 ("Findings and Purposes"), Pub.L. 109-2, Feb. 18, 2005, 119 Stat. 4.

Thus, *Gentry's* reliance on various *state* public policies supporting the availability of class actions as a way to defeat enforcement of arbitral class waiver clauses cannot be reconciled with any Congressional policy.

B. *Gentry's* Rationale Is Inconsistent With FAA Principles.

A major premise of *Gentry* is that in the absence of the availability of class relief, class members may be left with (citing *Bell*) "no more than the prospect of 'random and fragmentary enforcement' of the employer's legal obligation to pay overtime." *Gentry* at 462. The California court reasoned that the availability of class actions "eliminates the possibility of repetitious litigation" and warned of the "inefficiency" of separate, non-class proceedings. *Id.* at 459.

California's approach highlights a divergence of authority that should be reconciled by this Court. Indeed, this Court has rejected similar arguments as a ground for defeating enforcement of arbitration agreements. *See Dean Witter Reynolds v. Byrd,* 470

U.S. 213, 217 (1985) ("[the FAA] requires district courts to compel arbitration of pendent arbitrable claims when one of the parties files a motion to compel, even where the result would be the possibly inefficient maintenance of separate proceedings in different forums"); *Moses H. Cone* (rejected the inefficiency argument, explaining, "[t]hat misfortune, however, is not the result of any choice between the federal and state courts; it occurs because the relevant federal law *requires* piecemeal resolution when necessary to give effect to an arbitration agreement"). *Accord*, *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 293-294 (2002); *Casarotto* at 688; *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. at 54; *Volt Info. Scis., Inc. v. Board of Trustees of the Leland Stanford Junior Univ.*, 489 U.S. at 475-479 (all holding that arbitration agreements must be enforced in accordance with their terms). *See also Phila. Reinsurance Corp. v. Emplrs. Ins. of Wausau*, 61 Fed. Appx. 816, 819 (3rd Cir. 2003) ("A district court must [] abide by the terms of the parties' agreement [to arbitrate] even if it produces inefficient results"); *Coors Brewing Co. v. Molson Breweries*, 51 F.3d 1511, 1517 (10th Cir. 1995) (litigation must proceed in "piecemeal" fashion if the parties intended that some matters, but not others, be arbitrated); *Dean Witter Reynolds, Inc. v. Prouse*, 831 F. Supp. 328, 331 (S.D.N.Y. 1993) ("the intent of the [FAA] is to enforce private arbitration agreements even at the expense of complex and inefficient dispute resolution"); *Smith v. Pay-Fone Systems, Inc.*, 627 F. Supp. 121, 125 (N.D.

Ga. 1985) ("the mere fact that plaintiff's antitrust claims may be intertwined with the arbitrable claims is no longer a basis for denying arbitration"); *Brown v. E.F. Hutton & Co.*, 610 F. Supp. 76, 79 (S.D. Fla. 1985) ("Arbitrable claims should be submitted to arbitration without regard to the status of the claims to be litigated in court"); *Hallmark Indus. v. First Systech Int'l, Inc.*, 203 Ariz. 243, 246 (2002) ("Any inefficiency or risk of inconsistent results is a consequence of the parties' bargaining").

Even the California Supreme Court, in a previous decision, has rejected this argument. *Vandenberg v. Superior Court*, 21 Cal. 4th 815, 831 (1999) ("policies favoring the efficiency of private arbitration as a means of dispute resolution must sometimes yield to its fundamentally contractual nature, and to the attendant requirement that arbitration shall proceed as the parties themselves have agreed").

CONCLUSION

The instant case is of paramount importance to the many employers who have employees covered by arbitration agreements. California's increasing divergence from FAA principles must be checked. The writ of certiorari should be granted.

Respectfully submitted,

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No. 07-998 (3)

IN THE
Supreme Court of the United States

CIRCUIT CITY STORES, INC.,
Petitioner,

v.

ROBERT GENTRY,
Respondent.

On Petition for a Writ Of Certiorari to the Supreme Court of California

BRIEF *AMICUS CURIAE* OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA IN SUPPORT OF PETITIONER

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INTEREST OF THE *AMICUS CURIAE*

The Chamber of Commerce of the United States of America (amicus, its members) respectfully submits this *amicus curiae* brief in support of petitioner Circuit City Stores, Inc.'s ("Circuit City") petition for a writ of certiorari to review the decision and judgment of the California Supreme Court (the "Petition").[1]

The Chamber is the world's largest business federation, representing an underlying membership of more than 3,000,000 businesses and organizations of every size. Chamber members operate in every sector of the economy and transact business throughout the United States, as well as in many countries around the world.

A central function of the Chamber is to represent the interests of their members in important matters before the courts, Congress and the Executive Branch. To that end, the Chamber has filed *amicus curiae* briefs in numerous cases that

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[1] Pursuant to Supreme Court Rule 37.6, no counsel for a party authored this brief in whole or in part and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than the Chamber or its counsel made a monetary contribution to its preparation or submission. Further, Counsel of Record for all parties received notice at least 10 days prior to the due date of the Chamber's intention to file this brief. All parties have also consented to the submission of this *amicus curiae* brief. Therefore, in accordance with Supreme Court Rule 37.2, the Chamber will not file an accompanying motion for leave to file.

have raised issues of vital concern to the nation's business community.

Many of the Chamber's members, constituent organizations and affiliates routinely use uniform contracts to provide order to their affairs. In the course of their businesses, these members and affiliate organizations have adopted provisions that mandate the arbitration of disputes arising from or related to contracts that they have entered into with their employees, consumers or other parties. They use arbitration because it is a speedy, fair, inexpensive and effective method of resolving disputes. Because many of these advantages would be lost if the decision below is allowed to invalidate or call into question the kind of agreements which are at issue in this case, the Chamber has a strong interest in having its views on the validity of such agreements considered by the Court. Not only does the Chamber have a strong interest in the proper resolution of this case, its familiarity with arbitration law and doctrine may be of assistance to the Court.

SUMMARY OF ARGUMENT

This case presents the Court with the opportunity to answer for millions of businesses and their employees the persistent question of whether the pro-arbitration objectives of the Federal Arbitration Act ("FAA") must be subordinated to the mandates of state statutes and policies that are alleged to conflict with these objectives. In

answering this question, the Court will either uphold the validity of millions of contracts reflecting the intent of parties to arbitrate employment and other disputes, or throw these contracts into jeopardy by subjecting them to the strictures of state decisions that render these agreements unenforceable.

The statutory history of the FAA and the Court's prior decisions applying the FAA demonstrate a clear national policy in favor of arbitration. Businesses have taken this history and court precedent to heart and have worked for decades to provide arbitration as an alternative to litigation for the resolution of employment and other disputes. The decision below, however, attempts to reverse these efforts. The invalidation of the kinds of agreement at issue in the instant case would have far-reaching, negative consequences for both employers and employees and would call into question the validity of hundreds of thousands of similar contracts that have been carefully crafted to take advantage of the arbitral forum. These agreements reflect the parties' recognition of the well-documented benefits of arbitration -- more favorable outcomes, cost savings, and the speed of resolving disputes -- as compared to litigation.

In March 1995, respondent Robert Gentry entered into a Dispute Resolution Agreement (the "Agreement") with petitioner Circuit City in connection with his employment by Circuit City as a sales associate. The Agreement provided that any disputes arising out of Gentry's employment with

Circuit City would be settled exclusively by individual arbitration. Ignoring his obligations under the Agreement, on August 20, 2002, Gentry filed a class action in California state court against Circuit City seeking to collect overtime pay on behalf of himself and a class of other employees.

The California Superior Court and Court of Appeal held that Gentry must arbitrate his claims individually pursuant to the agreement he had entered with Circuit City. The California Supreme Court reversed and declined to apply the FAA to enforce Gentry's arbitration agreement in two similarly flawed ways. First, the court below refused to enforce the parties' arbitration agreement based on state policies that do not apply to "any contract," in direct conflict with the language of Section 2 of the FAA and this Court's decision in *Perry v. Thomas*, 482 U.S. 483 (1987). Second, the court below applied an unconscionability analysis that was hostile toward arbitration and thus in conflict with this Court's decisions in *Perry* and *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996).

Unless the Court intervenes to uphold the vigorous application of the FAA and confirm the enforceability of the arbitration agreement in this case, the decision below will thwart the longstanding efforts of Congress and United States businesses to advance arbitration as a viable and efficient alternative to litigation. This will be the case not only for disputes that arise in the employment context but also for those that arise in myriad other

contexts. As a result, businesses will be discouraged from continuing to provide a forum for the arbitration of disputes as the enforceability of these agreements will be far from certain. Ultimately, employees and others will no longer have the option of choosing arbitration over costly and protracted litigation.

ARGUMENT

I. The Statutory History of the FAA and the Prior Decisions of this Court Strongly Favor the Enforcement of Arbitration Agreements.

Section 2 of the FAA provides that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds that exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. In enacting Section 2 of the FAA, Congress "declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims that the contracting parties agreed to resolve by arbitration." *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984). The primary purpose of the FAA "was to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, and to place arbitration agreements on the same footing as other contracts." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991). Indeed, Congress recognized early on the

benefits of offering an arbitral forum as an alternative to litigation for settling disputes:

> It is practically appropriate that the action should be taken at this time when there is so much agitation against the costliness and delays of litigation. These matters can be largely eliminated by agreements for arbitration, if arbitration agreements are made valid and enforceable.

H.R. Rep. No. 68-96, at 2 (1924).

Since its enactment in 1925, this Court has interpreted the FAA to hold that "questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration" and that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983). This Court has applied the FAA to enforce arbitration agreements in connection with a variety of statutory claims. *See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985) (Sherman Act claims); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987) (Securities Exchange Act claims); *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989) (civil RICO claims). In all these cases, the Court has consistently endorsed the pro-arbitration policy embodied in the FAA.

In *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001), the Court specifically confirmed the enforceability of agreements to arbitrate in the employment context, reasoning that "[a]rbitration agreements allow parties to avoid the costs of litigation, a benefit that may be of particular importance in employment litigation, which often involves smaller sums of money than disputes concerning commercial contracts." *Id.* at 123.

II. The Decision Below Calls into Question the Validity of Numerous Arbitration Agreements Intended to Govern Employment Disputes.

Businesses have been encouraged by the Court's intent to "rigorously enforce agreements to arbitrate." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985). Relying on the pro-arbitration policy espoused by the FAA and the Court's decisions supporting that policy, businesses over the past several decades have invested significant effort and resources to develop and implement policies that facilitate arbitration in the employment context. Many of the Chamber's 3,000,000 members, constituent organizations and affiliates have adopted, as standard features of their contracts, provisions that mandate the arbitration of disputes arising from or related to those contracts. These businesses have done so recognizing the advantages to both employers and employees of arbitration in resolving employment disputes.

Arbitration "saves time, saves trouble, saves money." *Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary,* 68th Cong., 1st Sess. 7 (1924) (statement of Charles Bernheimer, N.Y. Chamber of Commerce); *see also* H.R. Rep. No. 97-542, at 13 (1982) (arbitration is "cheaper and faster than litigation," has "simpler procedural and evidentiary rules," "minimizes hostility," and is "more flexible in regard to scheduling"). Arbitration has proven to be an inexpensive, prompt, fair and effective method of resolving disputes with employees and other contracting parties. Employees may file and pursue arbitration at minimal cost. In contrast to the high costs of litigation, a large percentage of individuals who bring claims in arbitration pay nothing to pursue their claim. Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration under the Auspices of the American Arbitration Association*, 18 OHIO ST. J. ON DISP. RESOL. 777 (2003). Indeed, a growing number of arbitration agreements provide that businesses will pay or advance all fees associated with them. This is certainly the case here where the parties' arbitration agreement provides that petitioner Circuit City will pay all arbitration-related fees.

Arbitration is also faster than litigation. Data on federal and state court caseloads reveal an overburdened judicial system in which delays for litigants are common. A civil case filed in a federal district court today faces, on average, a delay of over two years before reaching trial. U.S. Courts, U.S.

District Court - Judicial Caseload Profile (2007), http://www.uscourts.gov/cgi-bin/cmsd2007.pl. Parties fare no better in state court where, in 2001, a contract suit took 25 months on average to reach judgment. Bureau of Justice Statistics, Contract Trials and Verdicts in Large Counties, 2001 (2005), http://www.ojp.usdoj.gov/bjs/pub/pdf/ctvlc01. pdf.

In contrast, arbitrations administered by the American Arbitration Association ("AAA"), the largest arbitration provider in the United States, proceed to an award in an average of four to six months. AAA, Analysis of the American Arbitration Association's Consumer Arbitration Caseload (2007), http://www.adr.org/si.asp?id=5027. Moreover, far from supplanting the role of the courts in adjudicating claims, arbitration in fact relieves the judicial system of a significant volume of disputes which otherwise would add to the already over-taxed dockets of state and federal courts. In 2002, the AAA reported that it had handled approximately 200,000 arbitrations. Deborah R. Hensler, *Our Courts, Ourselves: How the Alternative Dispute Resolution Movement is Re-Shaping our Legal System*, 108 PENN ST. L. REV. 165, 167 n.11 (2003). That is approximately 80 percent of the number of civil cases handled in federal courts in 2006. *Id.* Adding these disputes to the current backlog in the courts would only compound delays for litigants.

Arbitration also has evolved to address many of the due process concerns raised by resolving disputes outside of the judicial system. All three of

the nation's largest arbitration providers -- AAA, JAMS and the National Arbitration Forum -- have adopted policies to provide parties who submit to arbitration with the highest standards of fairness and due process. These policies include, giving employees the right to pick or veto a particular arbitrator, strict disclosure obligations for arbitrators regarding potential conflicts, limitations on arbitration costs for employees, and rules governing discovery. AAA, Employment Due Process Protocol (1995), http://www.adr.org/sp.asp?id=28535; JAMS, Policy on Employment Arbitration Minimum Standards of Fairness (2005), http://www.jamsadr.com/rules/employmentArbitration_min_stds.asp; National Arbitration Forum, Code of Procedure (2007), http://www.adrforum.com/users/naf/resources/20070801CodeofProcedure.pdf; National Arbitration Forum, Arbitration Bill of Rights (2007), http://adrforum.com/users/naf/resources/ArbitrationBillOfRights3.pdf.

Finally, arbitration has yielded more favorable outcomes for employees than litigation. For example, the National Workrights Institute found that employees were almost 20 percent more likely to win employment cases in arbitration than those litigated in court. National Workrights Institute, Employment Arbitration: What Does the Data Show? (2004), http://workrights.org/current/cd_arbitration.html. Another study shows that plaintiffs who opt for employment arbitration in the securities industry

are 12% more likely to win their disputes than employees who litigate in federal court in the Southern District of New York. Michael Delikat & Morris M. Kleiner, *An Empirical Study of Dispute Resolution Mechanisms: Where do Plaintiffs Better Vindicate Their Rights?*, DISP. RESOL. J. (2003-04).

With respect to monetary recoveries, arbitration awards obtained by plaintiffs are typically the same as or larger than court awards. *Id.* In a recent study of parties who had participated in an arbitration, over 70 percent were satisfied with the fairness of the process and the outcome, including a significant number of those who had lost their arbitrations. Harris Interactive Survey, U.S. Chamber Institute for Legal Reform, Arbitration: Simpler, Cheaper, and Faster Than Litigation 24-26 (2005), http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005HarrisPoll.pdf.

It comes as no surprise then that businesses increasingly have offered, and employees have chosen, to arbitrate disputes arising in the context of employment. Indeed, arbitration has become a regular fixture in most dispute resolution schemes. In this case, Circuit City provided Mr. Gentry with a reasonable period to opt out of arbitration and in no way conditioned continued employment on the execution of an arbitration agreement. Indeed, Circuit City's arbitration agreement provides that Circuit City will absorb all arbitration-related fees and permits employees to recover remedies in

arbitration to the full extent that they may have recovered in court. With all these indicia of fairness, the parties were entitled to expect that their private choice to arbitrate would be honored and enforceable.

The decision below throws these and other similar arrangements into jeopardy and threatens to dismantle the carefully constructed arbitration policies of countless businesses. The magnitude of the number of contracts affected by the decision below is at least in the hundreds of thousands, if not millions. And because the holding can be read to extend beyond the employment setting, the negative effects will likely extend to a wide variety of other contracts containing arbitration provisions.

III. The California Supreme Court's Decision Flies in the Face of National Policy and Judicial Precedent.

The decision of the California Supreme Court conflicts with not only the statutory history favoring arbitration, but also with judicial precedent by precluding the application of the FAA in two ways. First, the California Supreme Court ruling ignores this Court's prior decision in *Perry v. Thomas*, 482 U.S. 483 (1987), which provides that a court may not decline to enforce an arbitration clause based on state law principles that are hostile to arbitration, as is the case here. Second, the court below applies an arbitration-specific unconscionability analysis that is not permitted under the FAA.

The California Supreme Court reversed the decisions of the Superior Court and Court of Appeal enforcing the arbitration agreement entered into between respondent Gentry and petitioner Circuit City because it required individual arbitration of Gentry's claims and, in some instances, might preclude Gentry from pursuing his unwaivable right to overtime pay under California law. The court identified a litany of factors to be considered in determining the enforceability of the arbitration agreement including, the size of any potential individual recovery, the potential for retaliation against members of the class, the fact that absent members of the class may be ill-informed about their rights and other "real world" obstacles to vindication of class members' right to overtime pay through individual arbitration.

As relevant to this case, this Court in *Southland Corp. v. Corp. v. Keating*, 465 U.S. 1, 16 (1984), held that the applicability of the FAA to enforce arbitration agreements extends to state, as well as federal, courts. Further, the Court in *Southland* explained that "Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." *Id.* at 3. This prohibition in *Southland* is precisely what the California Supreme Court's decision accomplishes by subordinating the FAA to state statutes governing overtime pay that do not apply to "any contract." 9 U.S.C. § 2. Under the Supremacy Clause, those state policies are preempted by Congress's

overriding interest in upholding arbitration agreements as embodied in the FAA.

Under Section 2 of the FAA, "only state law that addresses the enforcement of contracts generally is not preempted by the FAA." *Bradley v. Harris Research, Inc.*, 275 F.3d 884, 889 (9th Cir. 2001) (internal quotations and citation omitted). If a state law applies only to some but not all contracts, however, the state law cannot defeat an agreement to arbitrate. *See Bradley*, 275 F.3d at 889-90; *Stawski Distrib. Co., Inc. v. Browary Zywiec S.A.*, 349 F.3d 1023, 1024-26 (7th Cir. 2003); *OPE Int'l LP v. Chet Morrison Contractors, Inc.*, 258 F.3d 443, 447 (5th Cir. 2001) ; *KKW Enters., Inc. v. Gloria Jean's Gourmet Coffees Franchising Corp.*, 184 F.3d 42, 50-51 (1st Cir. 1999); *Doctor's Assocs., Inc. v. Hamilton*, 150 F.3d 157, 163 (2d Cir. 1998). Here, the state statute in question applies only to a narrow category of employment contracts. As such, provisions of California's state labor law do not constitute "grounds that exist in law or equity for the revocation of *any* contract" as required by Section 2 of the FAA for the invalidation of any arbitration agreement. 9 U.S.C. § 2 (emphasis added). Therefore, the state statute governing overtime pay provides no basis for refusing to enforce the agreement to arbitrate, and Gentry's agreement to arbitrate must be enforced.

In addition to conflicting with decisions of the Ninth, Seventh, Fifth, Second and First Circuits, the lower court's holding conflicts with this Court's

decision in *Perry*. *See* Petition at 15-24. In *Perry*, this Court found a conflict between Section 2 of the FAA and a California Labor Code provision which required that litigants be provided a judicial forum for resolving wage disputes. The Court concluded that, "under the Supremacy Clause, the state statute must give way" when presented with such a conflict. *Perry v. Thomas*, 482 U.S. 483, 491 (1987). The Court recognized "the pre-emptive effect" of the FAA and that "the preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered . . . ." *Id.* at 490 (quoting *Byrd*, 470 U.S. at 221).

More recently, this Court reaffirmed its holding in *Doctors' Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996), finding that the FAA supersedes state laws when state laws do not apply to contracts generally. *Preston v. Ferrer*, No. 06-1463, 2008 WL 440670, at *2 (Sup. Ct. Feb. 20, 2008) (state law conflicts with the FAA when it "imposes prerequisites to enforcement of an arbitration agreement that are not applicable to contracts generally"). The Court held that "when parties agree to arbitrate all questions arising under a contract, state laws lodging primary jurisdiction in another forum, whether judicial or administrative, are superseded by the FAA." *Id.*, at *3.

Second, the court below ruled that the Agreement was procedurally unconscionable because Circuit City did not inform Gentry of the disadvantages of arbitration under the Agreement

compared to litigation. This holding too runs afoul of this Court's decision in *Perry* which held that a "state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with . . . §2 [of the FAA]." *Perry*, 482 U.S. at 492. *Perry* stands for the proposition that a court may not construe an arbitration agreement in a manner different from that which it otherwise construes nonarbitration agreements under state law. *Id.* More specifically, the FAA prohibits states from "condition[ing] the enforceability of arbitration agreements on compliance with a special notice requirement not applicable to contracts generally." *Casarotto*, 517 U.S. at 687 .

The reason for such a rule is clear -- Congress did not intend to allow state legislatures to enact state laws or allow courts to subject arbitration to special scrutiny that would undercut the national policy favoring arbitration. Although the FAA allows certain general contract principles to remain in force, 9 U.S.C. § 2, the FAA forbids the application of state laws in a way that targets arbitration agreements and renders them unenforceable. In identifying Circuit City's failure to highlight the disadvantages of arbitration to Gentry as a basis for its unconscionability analysis, the court below accomplishes exactly that which Congress has forbidden state legislatures from doing, *i.e.*, "rely[ing] on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." *Perry*, 482

U.S. at 492. Therefore, the California Supreme Court's arbitration-specific unconscionability analysis is prohibited by the Court's decisions in *Perry* and *Casarotto*, and violates the letter and spirit of Section 2 of the FAA.

IV. The Decision Below Discourages the Use of Arbitration Agreements.

The holding below creates widespread confusion and uncertainty regarding the enforceability of arbitration agreements. The decision calls into question the validity of hundreds of thousands of contracts containing arbitration provisions. If employees are routinely permitted to abandon arbitration agreements in favor of litigation, employers will have no incentive to promote arbitrate as an option to settle employment disputes. With no assurance that arbitration agreements will be enforced, businesses inevitably will discontinue their use going forward. Employees as well will suffer from the resulting lack of opportunity to arbitrate employment disputes. The impact will be particularly harsh on employees with claims where arbitration provides the only hope of quick and inexpensive redress of grievances. Nothing could more frustrate the purpose of the FAA.

CONCLUSION

The Petition raises a question of grave concern to businesses, employees and other parties

to agreements to arbitrate. The reach and authority of the FAA to enforce arbitration provisions in employment and other contracts is seriously undermined by the decision below. If not overturned, the decision threatens to unravel numerous contracts based upon agreements to arbitrate and functionally diminish the use of arbitration agreements in the future. Moreover, the decision below clashes with the decisions of this Court and circuit courts across the nation, including decisions of the Ninth Circuit. For these reasons, the Chamber respectfully requests that the Court grant Circuit City's petition for writ of certiorari to review the decision and judgment of the California Supreme Court.

March 3, 2008

Respectfully submitted,

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No. 07-998

In the
Supreme Court of the United States

CIRCUIT CITY STORES, INC.,

Petitioner,

v.

ROBERT GENTRY,

Respondent.

On Petition for Writ of Certiorari to the California Supreme Court

BRIEF AMICUS CURIAE OF PACIFIC LEGAL FOUNDATION IN SUPPORT OF PETITIONER

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QUESTIONS PRESENTED

1. Whether the Federal Arbitration Act permits a court to refuse to enforce an agreement calling for individual arbitration based on state labor law policies that do not apply generally to "any contract." 9 U.S.C. § 2.

2. Whether the Federal Arbitration Act permits a state court to refuse to enforce an agreement to arbitrate based upon an unconscionability analysis "that takes its meaning precisely from the fact that a contract to arbitrate is at issue." *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987).

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INTEREST OF AMICUS CURIAE

PLF was founded 35 years ago and is widely recognized as the largest and most experienced nonprofit legal foundation of its kind. PLF litigates matters affecting the public interest at all levels of state and federal courts and represents the views of thousands of supporters nationwide. Among other things, PLF's Free Enterprise Project defends the freedom of contract, including the right of parties to agree by contract to the process for the resolution of disputes between them. To that end, PLF has participated as amicus curiae in many important cases involving the Federal Arbitration Act and freedom of contract in general, including *Hall Street Associates L.L.C. v. Mattel, Inc.*, pending docket no. 06-989; *Preston v. Ferrer*, No. 06-1463, 2008 WL 440670 (U.S., Feb. 20, 2008); *Cingular Wireless, LLC v. Mendoza*, 126 S. Ct. 2353 (2006); and the proceedings in this case in the California Supreme Court. *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007).[1]

INTRODUCTION AND SUMMARY OF ARGUMENT

In *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006), this Court reaffirmed that Congress enacted the Federal Arbitration Act (FAA), 9 U.S.C. §§ 1-16, to overcome judicial resistance to

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[1] Written consent was granted by counsel for all parties and lodged with the Clerk of this Court. All parties were notified of PLF's plan to file this brief more than 10 days before the due date. No counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than amicus curiae, its members, or its counsel made a monetary contribution to its preparation or submission.

arbitration and that the savings clause of Section 2 embodies the national policy favoring arbitration and places arbitration agreements on equal footing with all other contracts. Applying this federal substantive law to the states, this Court held that arbitration contracts are to be construed as any other contract, not subjected to more stringent review or disfavor because the subject matter is arbitration. The Court thus confirmed the holding of *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984).

These matters have been settled law for more than 20 years. California courts, however, still scrutinize arbitration with suspicion and dislike, and invalidate arbitration contracts with distressing regularity. Most commonly, California courts invoke unconscionability principles to invalidate the contracts. However, the unconscionability doctrine is not applied neutrally among all types of contracts, resulting in the disproportionate invalidation of arbitration provisions as opposed to other contracts. This feature of California jurisprudence interferes with the normal and proper functioning of the California marketplace, injuring businesses and consumers alike. Because employment contracts—including arbitration clauses—are ubiquitous throughout California, and because California courts are invalidating arbitration clauses at a rate far exceeding that of any other state, this case presents an important question that can be resolved only by this Court. The petition for writ of certiorari should be granted.

REASONS FOR GRANTING THE WRIT

I

CALIFORNIA'S UNCONSCIONABILITY DOCTRINE UNIQUELY DISFAVORS ARBITRATION CONTRACTS

California's reluctance to enforce arbitration contracts conflicts with the Federal Arbitration Act's policy of favoring arbitration. It also conflicts with the approach of other states and the federal circuit courts, which comply with the federal policy codified in the FAA. Because California's hostility toward arbitration contracts affects many millions of employees and businesses in the country's most populous state, this Court should grant the writ of certiorari to review and reverse the decision below.

With one procedurally bizarre and narrow exception, there is no statute in California, or any other state, that requires parties to a transaction to arbitrate disputes.[2] Nonetheless, arbitration frequently is described as "mandatory," by which those who oppose arbitration contracts generally mean either that (1) individuals must agree to arbitration if they wish to buy the product or continue being employed; or (2) by agreeing to arbitrate, the contract "mandates" individuals to resolve disputes by arbitration even if they later would prefer to go to court. Christopher R.

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[2] *See Hess Collection Winery v. Agricultural Labor Relations Board*, 140 Cal. App. 4th 1584, 1600-01 (Cal. Ct. App. 2006), *rev. denied* (Sept.13, 2006) (upholding validity of Cal. Labor Code § 1164, mandating "interest" arbitration (as opposed to "grievance" arbitration) between agricultural employer and workers, which compels the parties to submit to mediation imposing a collective bargaining agreement when the parties fail to agree on the terms of an initial bargaining agreement).

Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. Ill. L. Rev. 695, 706 (2001). This Court, however, has refused to invalidate arbitration agreements solely on the grounds that an individual must take-it-or-leave-it. *See Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 33 (1991) ("Mere inequality in bargaining power, however, is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context.");[3] *see also Pritzker v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 7 F.3d 1110, 1118 (3d Cir. 1993) (arbitration agreements are enforceable even if they involve unequal bargaining power). *Cf. Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 596-97 (1991) (upholding a forum-selection clause in cruise-line ticket).

One way that individuals seek to evade an arbitration provision in a contract is to invoke the unconscionability doctrine. Unconscionability is a notoriously flexible concept. *See* Joseph M. Perillo, Corbin on Contracts: Avoidance & Reformation § 29.1 (rev. ed. 2002) ("Unconscionability is one of the most

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[3] In 2002, Senator Edward Kennedy introduced a bill expressly to restrict the FAA to nonemployment agreements. S. 2435 (107th Cong.) (2002) ("A bill to amend title 9 of the United States Code to exclude all employment contracts from the arbitration provisions of chapter 1 of such title; and for other purposes.") *available at* http://thomas.loc.gov/cgi-bin/bdquery/z?d107:SN02435:@@@L&summ2=m& (last visited Feb. 11, 2008). This bill has since been reintroduced and referred to committee five times, but never made it out of committee. *See e.g.*, H.R. 2969 (109th Cong.) (2005) ("Preservation of Civil Rights Protections Act of 2005 – Amends the Federal Arbitration Act to modify the definition of commerce so as to exclude employment contracts from arbitration provisions"), bill history *available at* http://thomas.loc.gov/cgi-bin/bdquery/z?d109:HR02969:@@@L&summ2=m& (last visited Feb. 11, 2008).

amorphous terms in the law of contracts."). The flexibility no doubt stems from the original purpose of the unconscionability doctrine: to protect consumers. Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J. L. & Econ. 293, 302 (1975) ("Ideally, the unconscionability doctrine protects against fraud, duress and incompetence, without demanding specific proof of any of them."). However, the doctrine was not written to enable courts to do justice by rewriting contracts. In fact, in the official comments to Uniform Commercial Code § 2-302, the drafters explained that the unconscionability principle "is one of prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power." *See id.*, official comment 1 (emphasis added); *accord* Cal. Civ. Code § 1670.5, Legis. Comm. Cmt. (same).

While the FAA permits state courts to apply "ordinary principles of unconscionability," the FAA forbids state courts from implementing substantive state policies that undermine arbitration clauses. Moreover, "a state cannot evade FAA preemption simply by labeling procedures which are inconsistent with its substantive policies as unconscionable." Alan S. Kaplinsky and Mark J. Levin, *The Gold Rush of 2002: California Courts Lure Plaintiffs' Lawyers (but Undermine Federal Arbitration Act) by Refusing to Enforce "No-Class Action" Clauses in Consumer Arbitration Agreements*, 58 Bus. Law. 1289, 1295 (2003). Similarly, this Court's arbitration jurisprudence does not permit a state to use unconscionability as a ground for voiding arbitration agreements in certain classes of disputes just because the state court believes those disputes are better handled by some other means of dispute resolution. For example, this

Court held that the FAA preempts California Labor Code § 229 insofar as the state statute allowed litigation in court to collect wages "without regard to the existence of any private agreement to arbitrate." *Perry v. Thomas*, 482 U.S. 483, 484, 491 (1987) (quoting Cal. Lab. Code § 229 (West 1971)). This strongly suggests that California could not simply deem such an arbitration clause to be unconscionable and unenforceable to the extent it prevented an employee from suing in court to collect unpaid wages. *See Gold Rush*, 58 Bus. Law. at 1295. As one commentator noted:

> [T]he United States Supreme Court surely would review state courts' unconscionability rulings to the extent necessary to prevent the unconscionability doctrine from effectively nullifying the FAA with respect to a huge class of contracts. Indeed, the Court has twice stated that state courts may not "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what . . . the state legislature cannot."

Stephen J. Ware, *Alternative Dispute Resolution* § 2.25(b), at 58 (West 2001) (citing *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687-88 n.3 (1996)); *Perry*, 482 U.S. at 492 n.9. That is, a court may not "decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause." *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 281 (1995).

Nonetheless, California courts have found the unconscionability doctrine to be a valuable tool to

invalidate arbitration contracts. In so doing, California has developed a reputation as "hostile" to arbitration. A recent empirical analysis conducted by Stephen Broome revealed that unconscionability challenges in California succeed against arbitration provisions with far greater frequency than any other type of contract provision. Stephen A. Broome, *An Unconscionable Application of the Unconscionability Doctrine: How the California Courts Are Circumventing the Federal Arbitration Act*, 3 Hastings Bus. L. J. 39 (2006). Broome identified 114 cases in which the California Courts of Appeal considered the unconscionability of arbitration contracts; in 53 of those cases, the arbitration provision was held unconscionable and unenforceable and another 13 found some aspect of the arbitration provision to be unconscionable and severed it. *Id.* at 44-45.[4] Forty-eight cases upheld the arbitration contract. By way of contrast, of the 46 unconscionability claims made outside the context of arbitration, 41 of the contracts were upheld by the courts, while only 5 were struck down as unconscionable. *Id.* at 47. By targeting arbitration provisions for exceptionally harsh review under the unconscionability doctrine, California courts violate Section 2 of the FAA, which demands that arbitration contracts be considered on "equal footing" with any other contract. *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 225-26 (1987). *See also Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 at 36.

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[4] Broome's survey included cases decided from 1982 to 2006. The starting date was set by California's adoption of the currently existing unconscionability doctrine in *A & M Produce v. FMC Corp.*, 135 Cal. App. 3d 473, 486 (1982). Broome, 3 Hastings Bus. L.J. at 44 n.33.

II

CALIFORNIA COURTS REQUIRE MUTUALITY IN ARBITRATION CONTRACTS, BUT NOT OTHER TYPES OF CONTRACTS

What accounts for the difference in the courts' willingness to invalidate arbitration contracts as unconscionable as opposed to contracts in other contexts? Mostly, the culprit is a special test that California courts apply to unconscionability claims brought only against arbitration contracts. This test—the "mutuality test"—first appeared in *Stirlen v. Supercuts, Inc.*, 51 Cal. App. 4th 1519 (Cal. Ct. App. 1997), in which the court held that a contract that requires one party to arbitrate but not the other is so "one-sided" as to be unconscionable. *Id.* at 1532. The *Stirlin* court repeatedly labeled the contract between the parties as a "contract of adhesion," with the assumption that the label would be dispositive of the legal issues. *Id.* at 1533; see also *Kinney v. United Healthcare Servs.*, 70 Cal. App. 4th 1322, 1332 (Cal. Ct. App. 1999) (invalidating "unilateral obligation to arbitrate"). Yet this disdain of adhesion contracts itself betrays a certain bias.

> "The contract of adhesion is a part of the fabric of our society. It should neither be praised nor denounced. . . ." That is because there are important advantages to its use despite its potential for abuse. These advantages include the fact that standardization of forms for contracts is a rational and economically efficient response to the rapidity of market transactions and the high costs of negotiations, and that the drafter can

> rationally calculate the costs and risks of performance, which contributes to rational pricing.

Goodwin v. Ford Motor Credit Co., 970 F. Supp. 1007, 1015 (M.D. Ala. 1997) citing *Robertson v. The Money Tree of Alabama*, 954 F. Supp. 1519, 1526 n.6 and n.10 (M.D. Ala. 1997)).[5]

None of those advantages were even acknowledged by the California Supreme Court, however, and that court adopted the mutuality test in *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83, 117 (2000), announcing that arbitration agreements must contain a "modicum of bilaterality." Since *Armendariz*, more than two-thirds of the courts

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[5] Richard Epstein explains why the "mutuality argument" cannot be a legitimate basis for declaring a contract unconscionable:

> A could not complain if B decided not to make him any offer at all; why then is he entitled to complain if B decides to make him *better off* by now giving him a choice when before he had none? If A does not like B's offer, he can reject it; but to allow him to first accept the agreement and only thereafter to force B to work at a price which B finds unacceptable is to allow him to resort (with the aid of the state) to the very form of duress that on any theory is prohibited. There is no question of "dictation" of terms where B refuses to accept the terms desired by A. There is every question of dictation where A can repudiate his agreement with B and hold B to one to which B did not consent; and that element of dictation remains even if A is but a poor individual and B is a large and powerful corporation. To allow that to take place is to indeed countenance an "inequality of bargaining power" between A and B, with A having the legal advantage as he is given formal legal rights explicitly denied B.

Epstein, *supra*, at 297.

that invalidated arbitration provisions did so because the provisions lacked mutuality. Broome, 3 Hastings Bus. L.J. at 50-51; see also Michael Schneidereit, Note, *A Cold Night: Unconscionability as a Defense to Mandatory Arbitration Clauses in Employment Agreements*, 55 Hastings L.J. 987, 1002 (2004) ("[I]n *Armendariz*, the court honed California unconscionabilty law into a weapon that could be used against mandatory arbitration agreements."). Indeed, in *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005), the California Supreme Court employed a form of the mutuality test to strike down class-arbitration waivers. In the court's view:

> [C]lass action or arbitration waivers are indisputably one-sided. 'Although styled as a mutual prohibition on representative or class actions, it is difficult to envision the circumstances under which the provision might negatively impact Discover [Bank], because credit card companies typically do not sue their customers in class action lawsuits.'

Id. at 161 (quoting *Szetela v. Discover Bank*, 97 Cal. App. 4th 1094, 1101 (Cal. Ct. App. 2002), *cert. denied*, 537 U.S. 1226 (2002)). The court below relied on what it perceived as the one-sided nature of the contract in striking down Circuit City's class-arbitration waiver. *Gentry v. Superior Court*, 42 Cal. 4th at 470-72. Although some language in *Armendariz* suggests that lack of mutuality can be justified by "business realities," *Armendariz*, 24 Cal. 4th at 117, no lower court has yet identified a business reality sufficient to justify lack of mutuality in an arbitration agreement. Broome, 3 Hastings Bus. L.J. at 54, citing Michael G.

McGuinness & Adam J. Karr, *California's "Unique" Approach to Arbitration: Why This Road Less Traveled Will Make All the Difference on the Issue of Preemption Under the Federal Arbitration Act*, 2005 J. Disp. Resol. 61, 81 (2005). The mutuality test thus makes it significantly easier to challenge arbitration agreements as unconscionable.

Yet this Court held that "[t]he 'goals and policies' of the FAA . . . are antithetical to threshold limitations placed specifically and solely on arbitration provisions." *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. at 688. Given this straightforward holding, jurisdictions other than California have been unwilling to adopt a requirement of mutuality for arbitration agreements. *See, e.g., McNaughton v. United Health Care Servs. Inc.*, 728 So. 2d 592, 599 (Ala. 1999) (a mutuality approach relies on the "uniqueness of the concept of arbitration," "assigns a suspect status to arbitration agreements," and therefore "flies in the face of *Doctor's Associates*."). *See also Harris v. Green Tree Fin. Corp.*, 183 F.3d 173, 180 (3d Cir. 1999) ("substantive federal law stands for the proposition that parties to an arbitration agreement need not equally bind each other with respect to an arbitration agreement if they have provided each other with consideration beyond the promise to arbitrate"); *In re Pate*, 198 B.R. 841, 844 (S.D. Ga. 1996) (same result under Georgia law); *Munoz v. Green Tree Fin. Corp.*, 542 S.E.2d 360, 365 (S.C. 2001) ("the doctrine of mutuality of remedy does not apply here. An agreement providing for arbitration does not determine the *remedy* for a breach of contract but only the *forum* in which the remedy for the breach is determined.") (italics in original).

Meanwhile, outside the arbitration context, California courts do not demand mutuality either. *See Principal Mut. Life Ins. Co. v. Vars, Pave, McCord & Freedman*, 65 Cal. App. 4th 1469, 1488-89 (Cal. Ct. App. 1998) (unilateral mortgage agreement upheld because "[w]here sufficient consideration is present, mutuality is not essential."); *Hillsman v. Sutter Cmty. Hosp.*, 153 Cal. App. 3d 743, 752 (Cal. Ct. App. 1984) (upholding unilateral employment contract where consideration requirement is properly met; a "mutuality of obligation" is unnecessary).

Thus, California's "mutuality" approach to determining substantive unconscionability in arbitration provisions differs from the standard used to analyze ordinary contractual provisions for unconscionability. Under the mutuality test, the court relies on its own speculation that the arbitral proceeding itself *might* impede a party's ability to obtain the requested relief. In the decision below, the court went even further, speculating that unidentified *other* potential class members might find it difficult to assert their rights. *Gentry*, 42 Cal. 4th at 461 ("Some workers, particularly immigrants with limited English language skills, may be unfamiliar with the overtime laws. Even English-speaking or better educated employees may not be aware of the nuances of overtime laws with their sometimes complex classifications of exempt and nonexempt employees.") (citation omitted).

For nonarbitration contractual provisions, however, California courts invalidate contracts as unconscionable only upon evidence of measurable, inevitable hardship if the disputed term is enforced. *See Phoenix Leasing Inc. v. Johnson*, No. A089871, 2001 WL 1324778, at *6 (Cal. Ct. App., Oct. 29, 2001)

(invalidating provision that would have given lender $208,000 of unaccrued interest); *Ilkhchooyi v. Best*, 37 Cal. App. 4th 395, 411 (Cal. Ct. App. 1995) (invaliding landlord's attempt to appropriate a portion of the sale price of a lease); *Carboni v. Arrospide*, 2 Cal. App. 4th 76, 83 (Cal. Ct. App. 1991) (invalidating interest rate of 200% per annum on a secured $99,000 loan); *Ellis v. McKinnon Broadcasting Co.*, 18 Cal. App. 4th 1796, 1806 (Cal. Ct. App. 1993) (invalidating contract that gave employer all of employee's sales commissions (which were the employee's sole compensation) that were received after the employee left the company when the sales were generated by the employee prior to his voluntary departure); *Johnisee v. Kimberlite Corp.*, No. A107341, 2005 WL 1249198 at *8 (Cal. Ct. App., May 24, 2005) (same).[6]

Because such class action waivers are upheld in most other courts, consumers who wish to sue national corporations (and their counsel) can circumvent those waivers by the simple mechanism of initiating a class action lawsuit in California. They need only to find a plaintiff in California to take the lead and file suit in state court, and then, once the lawsuit is under way, broaden the class action to include plaintiffs from around the country. *See* Aaron C. Gundzik & Rebecca Gilbert Gundzik, *Will California Become the Forum of Choice for Attacking Class Action Waivers?*, 25-FALL Franchise L.J. 56, 59 (2005). Thus, although California consumers and businesses are most obviously affected by the California courts' refusal to

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[6] These five cases are the only ones identified by Stephen Broome where California appellate courts invalidated contracts as unconscionable outside the arbitration context. *See* Broome, 3 Hastings Bus. L.J. at 56-58.

enforce class action waivers in arbitration, the true impact is national in scope and warrants this Court's review.

CONCLUSION

The California courts consistently hold arbitration agreements to a different standard when it comes to unconscionability, and the decision below represents the latest, and most extreme, example. Five years ago, then-Justice Janice Rogers Brown explained that "this court appears to be 'chip[ping] away at' United States Supreme Court precedents broadly construing the scope of the FAA 'by indirection,' despite the high court's admonition against doing so" and "urge[d]" this Court "to clarify once and for all whether our approach to arbitration law comports with its precedents." *Little v. Auto Stiegler, Inc.*, 29 Cal. 4th 1064, 1095 (2003) (Brown, J., concurring and dissenting) (quoting *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 122 (2001). This Court remains the only recourse to

reestablish the validity of arbitration agreements in the nation's most populous state.

The petition for writ of certiorari should be granted.

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Respectfully submitted,

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